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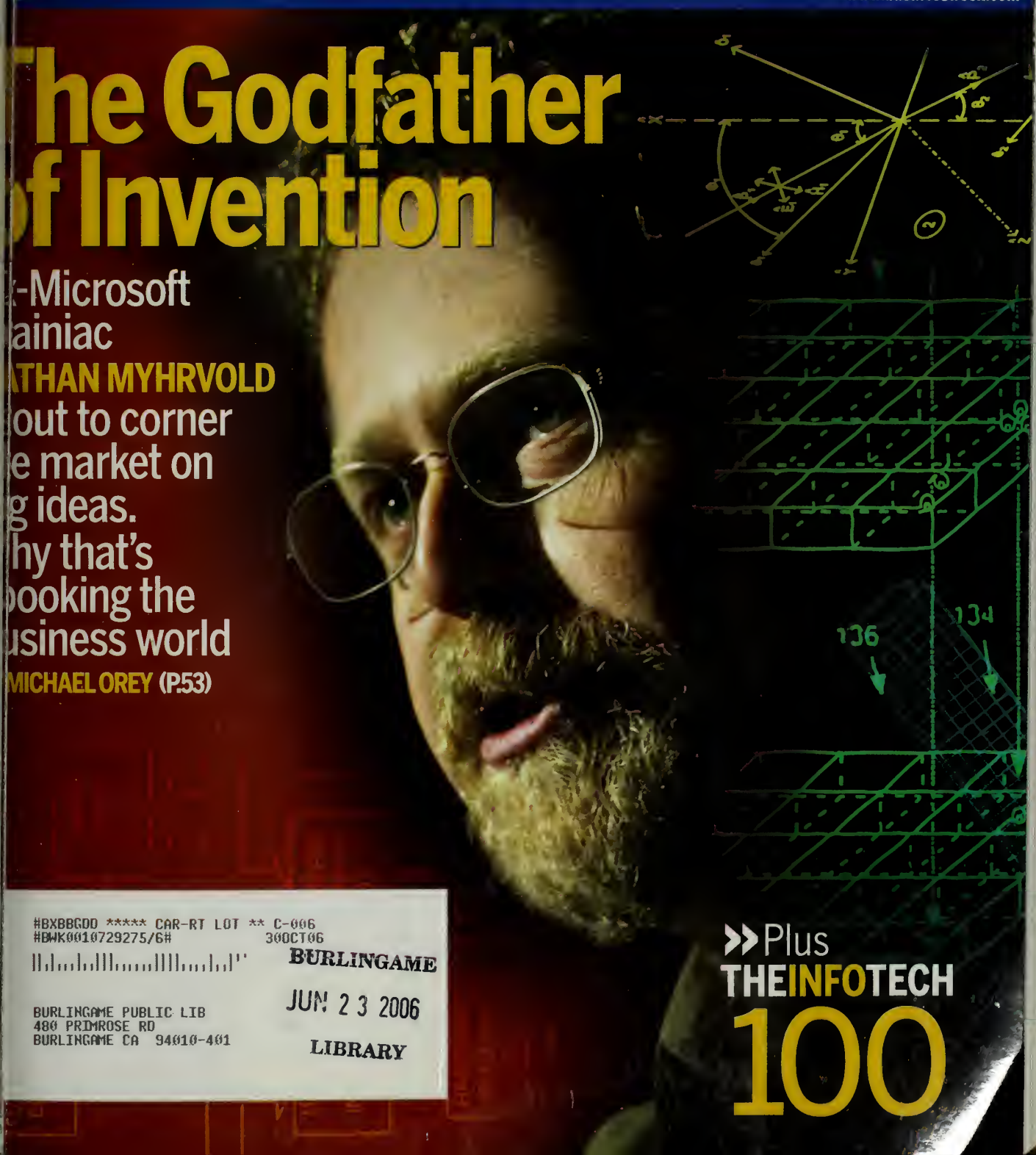

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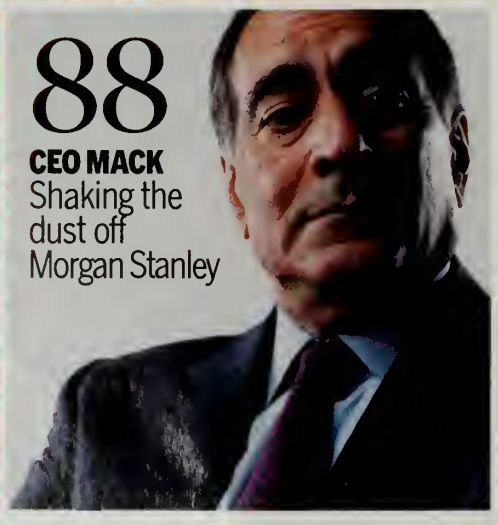

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What the pros need to wear around their necks.

Check out the photographers at any major sports event—PGA TOUR events include the same technology and innovation that makes Canon the overwhelming choice of

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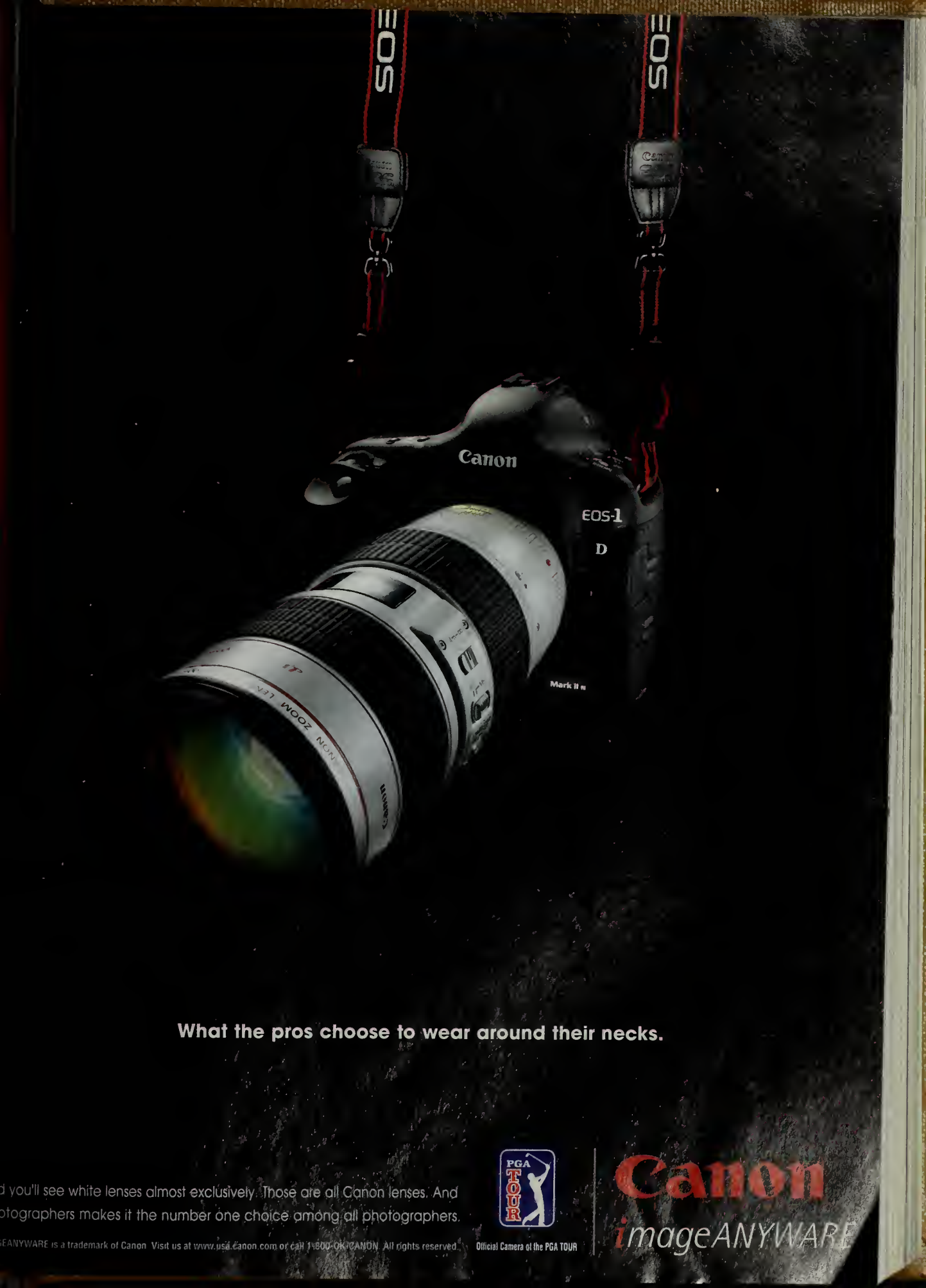

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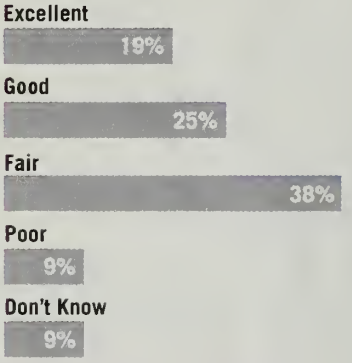

Results as of 6/15/06.

THIS WEEK'S QUESTION:

HOW EAGER ARE YOUR EMPLOYEES TO USE NEW TECHNOLOGY?

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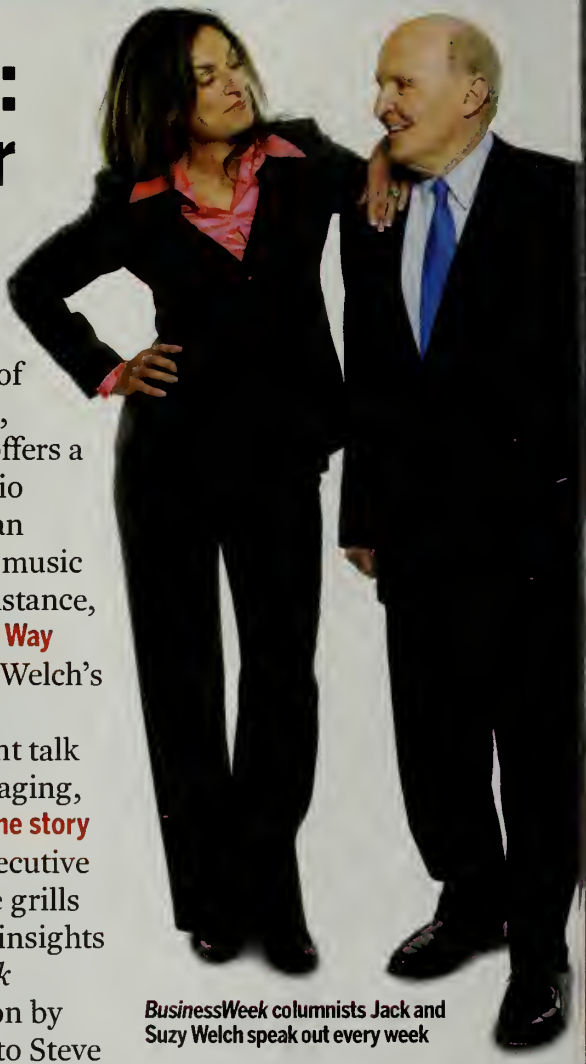

BusinessWeek columnists Jack and Suzy Welch speak out every week

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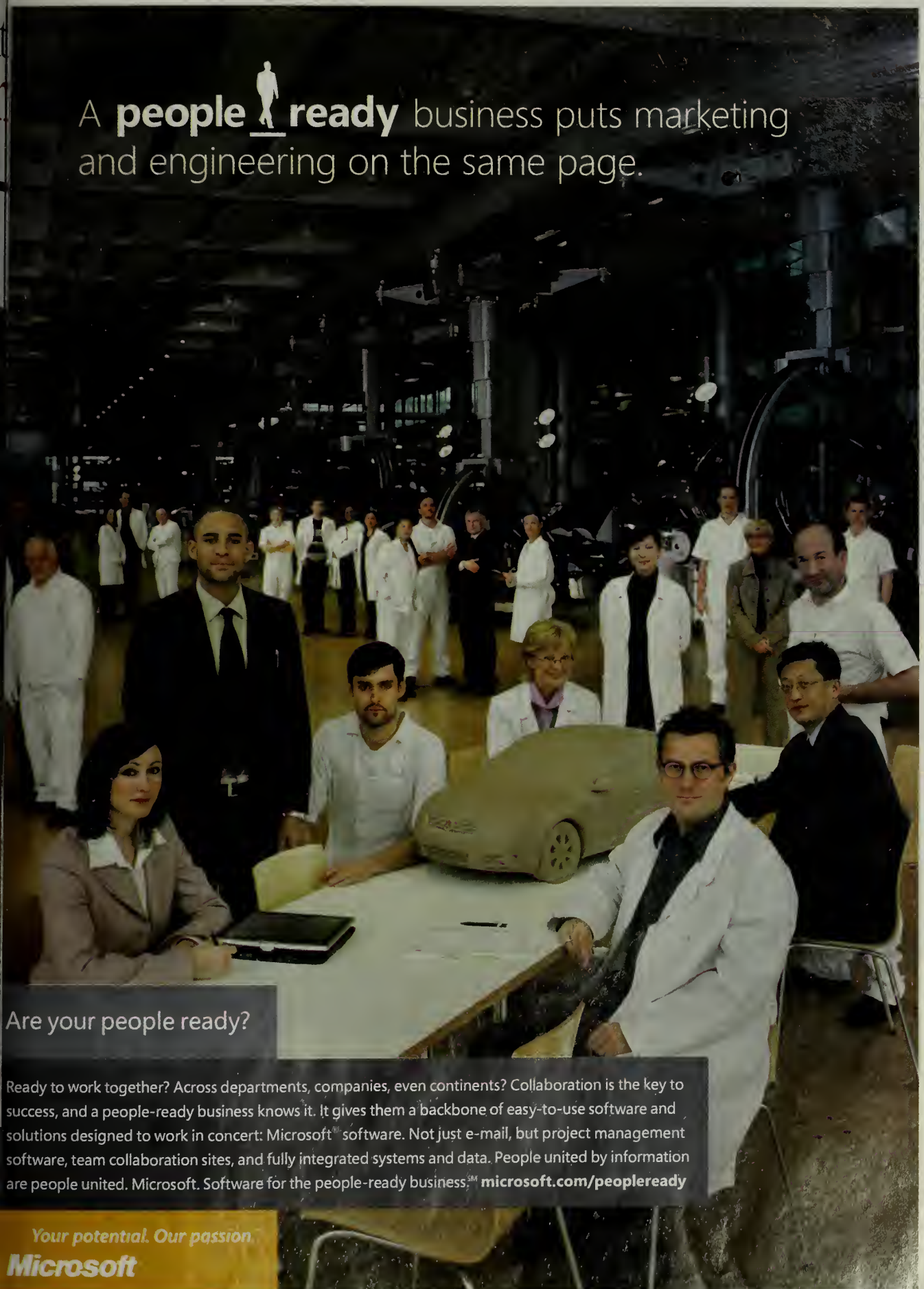

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"There's only so much corn to go around."

–John Hofmeister, U.S. chairman of Shell, commenting on a surge in the demand for ethanol, on Bloomberg News Online

TED BY DEBORAH STEAD

OP JOBS

HE TEMP I THE ORNER OFFICE

MPANIES are discovering a werful new breed of temp rker: the interim CEO. Last ır nine top-tier companies l temporary chiefs, ording to a study by blic-relations firm ber Shandwick, from just two in 04. The firm's ief reputation ategist, Leslie ines-Ross, ributes the rise to gher-than-usual CEO nover and increased board llingness to boot lackluster Os even before finding a rmanent replacement. Over the past three years e tenure of transient execs eraged only 159 days, but get this: Most performed better than their permanent CEO peers. Shares of companies with interim CEOs in that period outperformed a stock index of peer organizations by a median of 8.1%. One reason, Gaines-Ross suggests: shareholder relief "that the company's strategic direction is finally in new hands." Or perhaps being just a substitute gives one the courage to make bold changes. The study could give a boost to short-timers such as Claire Babrowski of **Radio Shack,** Rick Snyder of **Gateway,** and Michael Strianese of **L-3 Communications.** After all, some temp chiefs, like Carl Camden of **Kelly Services** (yes, the temp agency), do so well that they ultimately land the job. *–Diane Brady*

HE BIG PICTURE

EB MEDS Big Pharma spent $13.8 million on ternet ads in the first quarter, up slightly from year earlier. Looks like money well spent. octors grant 87% of patient requests for ecific drugs, and many patients consult the eb for guidance. *–Arlene Weintraub*

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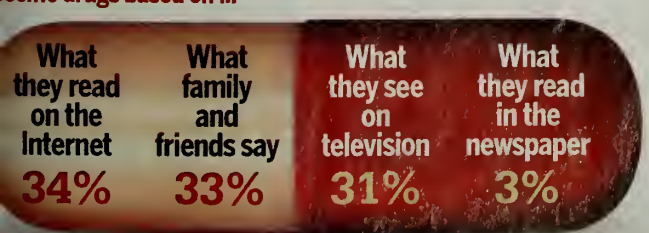

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EISNER "I went from a company of 125,000 to 3"

SECOND ACTS

Life Outside the Magic Kingdom

MICHAEL EISNER swears there is life after moguldom and projects to pursue beyond his flop **CNBC** talk show, *Conversations with Michael Eisner*. At a recent dinner given for him by ***The Week*** magazine at Manhattan's **Four Seasons** restaurant, Eisner was tan, relaxed, and trying not to sound vindictive about his final embattled days at **Walt Disney** last year. He opened up before 60 or so media cognoscenti, telling Sir Harry Evans, *The Week*'s editor at large, that he's working at home with two MBA students who are deferring their schooling. "I went from a company of 125,000 to 3," he joked.

Team Eisner is investing in an independent animated film, among other things. A dream project, Eisner said, would be to make a movie of *The 9/11 Report, A Graphic Adaptation*, a sort of narrative comic book (based on *The 9/11 Commission Report*) to be published this fall by **Farrar, Straus & Giroux.** Asked about successor Robert Iger's plan to put Steve Jobs on Disney's board when Disney completes its purchase of **Pixar Animation Studios,** Eisner, who had a bitter standoff with Jobs about distributing Pixar films, said: "I probably wouldn't have done that." A notorious micromanager, Eisner also said he'd like to write a book about the art of managing that way: "You don't think Bill Gates knows every little thing that is going on at Microsoft?" *–Tom Lowry*

UPFront

BLOGSPOTTING

LOTS OF MILEAGE OUT OF 'RUBBISH'

IT'S THE INTERNET vs. ink. **General Motors'** FYI blog (fyi.gmblogs.com) has been buzzing ever since company spokesman Brian Akre submitted a letter to ***The New York Times*** earlier this month

HUMMER

in response to columnist Thomas Friedman's May 31 column. Friedman had denounced the company's program of offering subsidized gas cards to Florida and California buyers of certain GM models, including Hummers and SUVs. Among other things, Friedman wrote that GM was "like a crack dealer" for gas addicts and was "dangerous to America's future." GM posted a rebuttal on its blog. It also sent a letter to the *Times*, pointing to the hybrid buses and fuel-efficient cars in its line and characterizing Friedman's assertions with strong language of its own: "What rubbish."

The two words became a contentious point for Akre and the *Times*, whose editors explained in e-mails that "it's not the tone we use in Letters" and suggested the phrases "We beg to differ" or "Not so" instead. Akre withdrew the letter, then blogged an item on GM's site titled "The Ban on 'Rubbish' in *The New York Times*," with links to the various versions of his proposed letter and to copies of the e-mails to and from the *Times*. The postings in response piled up in "overwhelming" numbers, says Akre, many but not all in support of GM.

Perhaps more important, "The Ban on Rubbish" was picked up by other media outlets, including *Automotive News*, autoblog.com, and the popular gawker.com (which, poking fun at what it called a "battle royale," linked to both GM's blog and Friedman's column).

So when Friedman responded in a June 14 column to GM's first blogged rebuttal, the company went only to the Web to reply. Akre says he now believes the *Times* did GM a favor by forcing it to react in cyberspace. Citing the adage about not picking a fight with someone who buys ink by the barrel, he says: "Well, you don't need ink."

–Romy Drucker

VOETBAL FEVER

FIGURING people in the Netherlands might play hooky to watch the World Cup, Dutch insurance broker SEZ is selling special coverage to employers, one that reimburses a company for an employee's calling in sick on the day of (and after) a World Cup match featuring the national team. Companies pay a premium of 2% to 4% of an employee's salary. In return, the policy covers the cost of an AWC worker's salary for up to two days—money that can be used to pay a temp. Since SEZ offered the coverage on its Web site four weeks ago, almost 400 employers have signed up, says Nel Karssens, SEZ president. "World Cup sickness," he notes, is contagious. *–Aili McConn*

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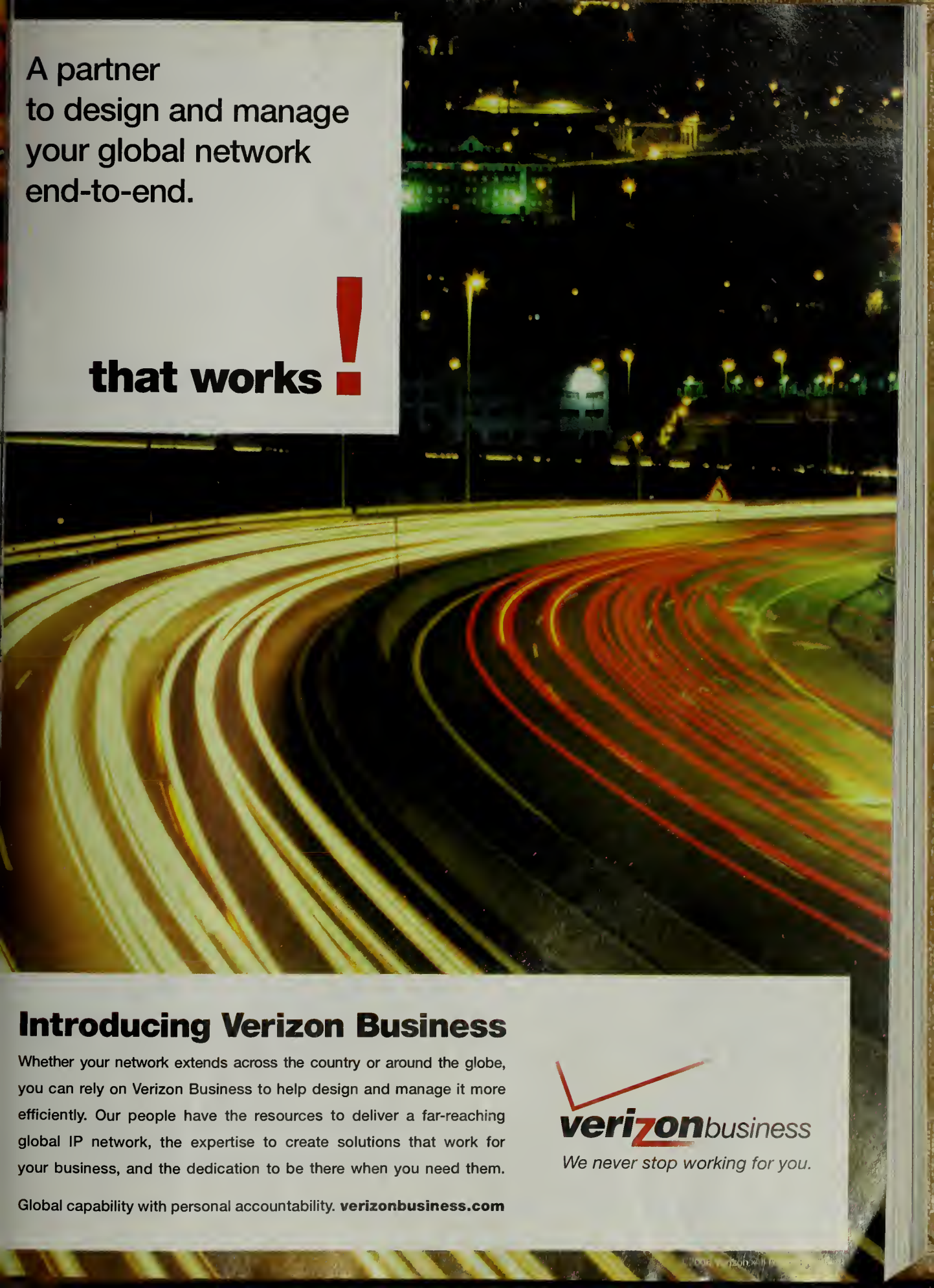
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LIFE'S LIKE THAT, DOLLFACE

Few brands resonate with girls as strongly as Mattel's $400 million-a-year American Girl doll. So when Mattel said that it will close its online American Girl Club in August, high-profile media blogger Jeff Jarvis objected on behalf of 9-year-olds like his daughter. The subscription-based club lets girls send messages to other doll owners, and Jarvis says his daughter is heartbroken about the closure. "I'll bet that Mattel didn't know the obligation it took on when it started this community," Jarvis recently wrote in BuzzMachine.com, his blog. "It's like putting up a Berlin Wall around third grades the world around."

American Girl spokesperson Stephanie Spanos says revenue from subscriptions ($20 a year to join, $10 to renew) wasn't enough to justify operating costs. (The site has a staff that ensures sensitive data such as home addresses aren't shared.) As one of Jarvis' readers wrote: "Perhaps third grade is a good time for a girl to start learning that there are friends, and there is business."

–Christopher Palmeri

IN THE DUMPS

OUTSIDE PARIS, A STINK TANK

THE FRENCH nose, trained to sniff out the best in wines, perfumes, and cheese, has a new assignment: identifying odors in garbage and sewage. Paris-based utility giant **Suez**, which has a $14 billion-a-year business in water and waste-treatment services worldwide, has just opened an olfactometry lab. At its suburban Paris research center, technicians inhale air samples taken from dumps and sewage plants, trying to pinpoint what makes them stink. These "noses," as they're called, have been trained to use an "odor wheel," a diagram that groups smells into categories such as "fermented" and "putrid" and lists possible sources—say, rotten cabbage (fermented) or dead animal (putrid). The system was developed for Suez by Mel Suffet, a **UCLA** professor of environmental health sciences and an expert on analyzing smells and flavors.

Finding the source of odors makes it easier to neutralize them, according to Suez research chief Diane d'Arras. "It's not enough to know that something smells bad. We have to know what molecules to look for," she says. When sludge from one of Suez's Chilean sewage plants, for instance, was found to contain a substance that stank only when wet, the company installed machin to dry the sludge.

D'Arras says that even sophisticated lab equipmer is less sensitive to odors th the human nose, which ca identify airborne particles present in only a few parts per billion. *–Carol Matl*

WIRED LIFE

TEACHING THE PRESS RELEASE A NEW TRICK

WHO KNOWS BETTER than a marketer that the medium is the message? A midsize Boston PR agency, **SHIFT Communications,** has developed a press release made especially for the Internet. The impetus for this invention: Web 2.0, that second-generation wave of Net services that let people create content and exchange information online. To encourage PR folks to use these Web tools to get the attention of journalists and bloggers, SHIFT has developed a model for a "social media press release." The **Microsoft** Word-based format, a free download, mixes elements from traditional releases (pre-approved quotes, for instance) with technology-rich features. Press releases created from the template can incorporate company logos, video, and links to blog posts and traditional media coverage on the product being flogged. With a click, a PR exec can also send the finished press release to the popular consumer-generated news site **DIGG**. And a reporter or blogger getting the release can click through a dedicated Web page that collects mentions of the product in question. "This gives journalists everything one place," says Todd Defre who developed the format a SHIFT.

About 3,500 copies of the template have been downloaded since May 23, Defren says, and at least one company, media analyst Cymfony, has used the template to plug its e-book about today's media landsc Journalists, he adds, "will catch on to it, and the more they see it, the more they'll l it." (Advice from a former *Financial Times* journalist, Tom Foremski, inspired son of the format.) PR heavywei **Edelman** plans to unveil its V 2.0 press release, with simil features, this summer.

–Elizabeth Wo

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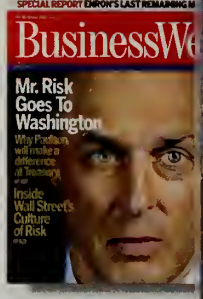
> "Mr. Risk will likely further entrench America's irresponsible, loophole-seeking executive culture of outsize compensation."
>
> *–Brad Mum Brue*
> *Seattle*



THE LAST THING POLITICIANS NEED IS MORE COMFORT WITH RISK

"MR. RISK GOES to Washington" (Cover Story, June 12) seems to affirm the appointment of Goldman Sachs Group's Henry "Hank" Paulson Jr. because he communicates about risk well and believes in it. The problem is, our national and state governments are increasing risk without proper safeguards. Growth with deficits works as a short-term strategy, but not when deficits are an addition to politicians unable to govern responsibly. I hope Paulson can provide inspiration and balance, but your article indicates that it will be more of the same, just articulated better.

–David Russell
Novato, Calif.

ONCE AGAIN, EXECUTIVES: YOU ARE NOT ABOVE THE LAW

INTERESTING THAT *BusinessWeek*'s June 12 issue focuses on how Enron's execs so carefully manipulated the letter of the law ("Enron's last mystery," Special Report). Also covered is misbehavior by executives at government-sponsored Fannie Mae ("It looks like Fannie had some help," News: Analysis & Commentary). And Mr. Risk, Hank Paulson, is described as the perfect pick for Treasury Secretary. Yet the Fan story says that "in 2001, Goldman Sac designed a mortgage-backed secur that it said in a Nov. 19 presentati would allow Fannie to 'better manage t recognition of income' for accounti purposes," according to an Office of Fe eral Housing Enterprise Oversight repo which also said that the transactions "h no significant purpose other than achieve desired accounting results."

Mr. Risk will likely further entrer America's irresponsible, loophole-seeki executive culture of outsize compensati noted in Mark Gimein's commenta "The Skilling trap" (News: Analysis Commentary). Bad behavior may be ra as Jack and Suzy Welch noted ("The r verdict on business," The Welch Way), l more of those at the top need to stop ha ing so much fun playing with the rules a start abiding by the spirit of the law.

–Brad Mum B
Sea

SAVINGS, WALL STREET, AND THE BENEFITS OF BUY-AND-HOLD

THANK YOU FOR the insightful arti "Inside Wall Street's culture of risk" (C er Story, June 12), on how Wall Street a

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investment bankers are ramping up risk. I, too, have taken risk to heart. Over the past two months I have taken the risk of building cash reserves. I have not had the advantage of eight computer screens and 36 sophisticated algorithms. Just pencil and paper and a little common sense.

–John Eysenbach
Brooksville, Me.

I FOUND IT INTERESTING to overlay simple 7% and 8% and 9% growth lines over the Standard & Poor's 500-stock chart. Guess what? Except for the "bubble," the chart tracks perfectly with the 8% growth line. "Hanging in" through the ups and downs does pay off.

–Sherwood Lennartson
Sewickley, Pa.

BIG LAW FIRMS ARE BIG BUSINESS—AND DESERVE SIMILAR SCRUTINY

RE "ENRON'S LAST mystery" (Special Report, June 12): It is remarkable that Vinson & Elkins' prominent role in Enron's business, combined with the recent indictment and trial of numerous general counsels of public companies, has not generated more involvement by CEOs and directors in selecting and overseeing major outside legal counsel engagements. External law firms actively participate in "bet the company" decisions regarding acquisitions, financings, competitive practices, and litigation. With numerous large law firms exceeding $1 billion in annual revenues, these "law businesses" must be viewed as major service providers subject to periodic scrutiny by senior executives in addition to the general counsel.

–Gary Rindner
Chappaqua, N.Y.

WHAT DELL IS DOING TO WIN BACK CUSTOMERS

RE "SATISFACTION NOT guaranteed" and "Dell: Facing up to past mistakes" (News: Analysis & Commentary, June 19): We have acknowledged that our service and support for consumer customers did not keep pace in the rapid growth of that market two years ago. Regrettably, we let some of our customers down. Dell's efforts to restore customer satisfaction include hiring 8,000 new service agents over a three-year period and providing additional training to current agents in our network of 30 global call centers; and implementation of new tools to assist our agents to better serve our customers, including DellConnect, a remote diagnostic tool that has been used for more than 500,000 service calls with a 95% satisfaction rate. We are also opening or expanding 14 facilities worldwide to better design, develop, manufacture, and service our products close to our customers.

Dell leads the industry in supporting commercial, government, and education customers, which account for 85% of the company's revenues. Dell has ranked first in the Technology Business Research Inc. Corporate IT Buying Behavior & Customer Satisfaction Study for 21 of the 22 quarters it has been conducted. And Dell was selected the top equipment brand in a survey by ACNielsen of information technology executives in the U.S. who cited Dell's value and outstanding customer service.

Dell is committed to regaining its leadership position in consumer service and support. Nothing short of being No. 1 in the eyes of all our customers is acceptable for us.

–Lynn A. Tyson
Vice-President for Investor Relations
& Corporate Commincations, Dell Inc.
Round Rock, Tex.

AIR TRAFFIC: DON'T LET THE BIG CARRIERS OFF THE HOOK

"SNARL IN THE SKY" (News: Analysis & Commentary, June 5) lets passenger airlines off the hook and inappropriately blames businesses that use their own aircraft for congestion in the nation's aviation system. Several critical points were missing entirely: Government organizations, including the Government Accountability Office, and aviation industry figures have said that the airlines' hub-and-spoke networks drive air traffic congestion. Business aviation is only a single-digit percentage of traffic at the 20 largest hub airports. Finally, you failed to note that business aviation flights typically take place at altitudes above and below passenger airline traffic, out of the way of the large commercial airplanes.

–Ed Bolen
President and CEO
National Business Aviation Assn.
Washington

FOR THE 20 MILLION people living in the New York-New Jersey-Philadelphia metropolitan area, the noise and pollution caused by already high private jet-aircraft traffic represents a sharp drop in quality of life for the convenience of just a few.

–Rich Baudisch
Montvale, N.J.

ON SUBURBAN ISSUES, ONE SIZE DOESN'T FIT ALL

RE "THE GOP HOMES in on the suburbs," Government, June 5): While we appreciate the efforts of the Republican suburban caucus in Washington, we, suburban Illinois legislators, belie that a one-suburb-fits-all approach the Republican national suburb agenda has severe shortcomings. takes existing local and state prograr and "nationalizes" them, adding a d plicate layer of bureaucracy with u funded mandates.

It misleads voters into believing that o communities and states are not addressi key issues of concern. It also ignores a h of federal programs, such as Special Ed cation, No Child Left Behind, and CREA (Chicago Region Environmental & Trar portation Efficiency Program), that ha been underfunded, leaving suburb schools and communities empty-hande

–State Senator Susan Garr
(D-Lake Fore
State Representative Elaine Nekr
(D-Des Plain
Springfield,

CORRECTIONS & CLARIFICATIONS

The subtitle for "The fire this time in China" (News: Analysis & Commentary, June 26) should have read, "Raging growth means Beijing must raise rates or revalue the yuan. Both are risky."

"How do you turn on the #@!&% air?" (News: Analysis & Commentary, June 19) should have clarified that the Mercedes S550 cited in the first paragraph did not appear in J.D. Power & Associates Initial Quality Study, also mentioned in the story.

In the next-to-the-last paragraph of "A real stake in your customers" (Entrepreneurs, June 19) the correct spelling of the surname of the Resource Interactive executive is Mooney (not Moody).

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Technology&You

BY STEPHEN H. WILDSTROM

Copyrights and Wrongs

I'm a fan of Bob Dylan's new *Theme Time Radio Hour* show on XM Satellite Radio, but I'm often not around at the times it is aired. So the idea that Pioneer's brand-new inno portable receiver can record XM broadcasts seemed perfect. But there's a problem. The recording industry doesn't want consumers to be able to buy an inno—or anything like it.

A group of record companies, backed by the Recording Industry Association of America (RIAA), has filed a suit in federal court in New York claiming the inno's recording ability violates copyright law. The complaint seeks a ban on the sale plus damages—as high as $150,000 for every song XM plays.

Unlike the music industry's fight against file sharing, this dispute has nothing to do with piracy. The inno, which we'll look at in detail in a future column, can store music recorded from XM. But once saved, the songs are locked in the device until they are deleted or the XM subscription lapses, when they vanish. And XM is paying about 7% of its gross revenues in music royalties. In other words, XM pays for broadcast rights and would-be pirates are thwarted.

THE CONSTITUTION AUTHORIZES COPYRIGHTS specifically "to promote the progress of science and useful arts." But the record companies, like the movie studios, are using copyright laws to try to protect their business models from innovative but disruptive technologies. This hurts us all.

The XM suit is complicated. (Surprise.) The basic claim is that the royalties XM pays allow it to provide an "evanescent satellite radio broadcast," but because the inno can record, XM effectively becomes a download service. XM has not formally responded to the suit, but Chance Patterson, vice-president for corporate affairs, calls it "baseless and without merit." The suit claims that the inno would discourage subscribers from paying for legitimate downloads. Wrong, says Patterson. The inno lets users tag songs they want to buy, he notes, and when they connect it to a PC, the tagged songs are automatically marked for purchase at Napster. Complete the purchase, and the songs download to the inno as MP3s.

Like all such lawsuits, this one's about money; the record companies want to extract more of it from XM and competitor Sirius Satellite Radio. The latter avoided a lawsuit by signing a license with three major record companies to pay extra royalties for its recording-capable S50 player. XM refused to roll over. But the XM case is also part of the futile effort by entertainment companies to control how customers use their products. More than 20 years ago the Supreme Court ruled it was permissible for consumers to tape television shows for personal viewing at a later time. The entertainment companies have been trying to win back ground ever since.

The studios say recording is allowed only if customers listen to the tracks exactly as XM sends them out. "The [XM] service is not designed for the purpose of permitting the user to listen to the program at a more convenient time . . .," the suit argues. "[But the inno] is designed to free subscribers from ever having to experience XM's transmissions as a unified, integrated radio broadcast."

The record biz could lose by winning its lawsuit over XM's recorder

I am not a lawyer, and I have no idea what the judge will do in this case. But I think this is one battle the record companies could lose by winning. The entertainment industry has grudgingly yielded ground in efforts to control how customers use its products. The TV networks have gone furthest toward giving up their established business model by letting customers watch selected shows where and when they want. Rather than emulating the movie studios, which are trying to defend their control over the times and places that films are available in different forms, the record companies should follow TV's lead and give customers what they want.

Changing a successful business model is painful. But businesses that fight the tide of consumers who want to push new technology to the max are likely to end up drowned.

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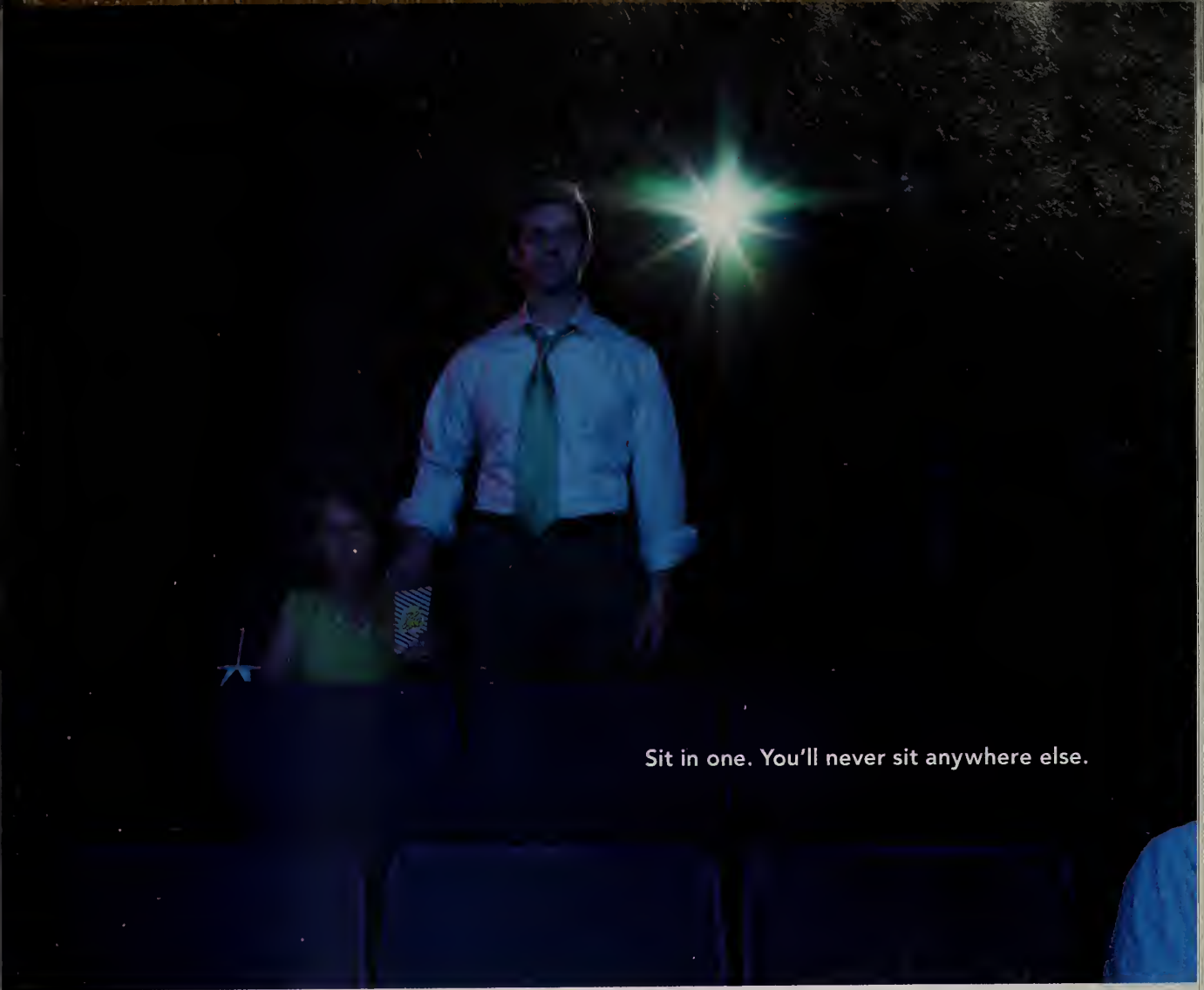

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Media, Marketing, and Advertising in the 21st Century

Screamfests Are So Old Media

If I may borrow someone else's adaptation, soon everyone will be famous for 15 people on the Web. That can even be where wider-world fame starts, because the Net is both farm team and idea incubator from which traditional players steal new notions and talent. Since January, Viacom's VH-1 has joined with corporate sibling video-sharing site iFilm.com to air its round-

up of online video, Web Junk 20. A woman named Tila Tequila, whose primary talent is wearing microscopic outfits, leveraged massive popularity on MySpace into a major label record deal.

Middle-aged pundits Mickey Kaus, author of the long-running blog kausfiles, and Robert Wright, a senior fellow at the centrist think tank New America Foundation, will never get massive on MySpace. But Wright's site bloggingheads.tv, on which he and Kaus tangle remotely via webcams on matters political, may portend a next generation of political talk shows. "In theory," Wright says, "narrower niche audiences should work now." Not that he has tested a business model yet. Bloggingheads launched last November and is ad-free, though Wright says if the audience keeps growing, a partner or investor and then—gasp—ads could follow.

WRIGHT AND KAUS Wonkiness reigns in their "diavlogs"

THE SITE IS SO STRENUOUSLY DEVOTED to eggheadedness that the aside "you are turning into Senator Moynihan" works as a joking inside reference to the late, famously erudite and self-referential New York pol. (Perhaps you had to be there.) Bloggingheads airs two or three hour-long face-offs each week, with Wright and Kaus appearing in tandem on one of them. But if the site has stars, it's them. "Star," in this context, doesn't mean Katie Couric. Here, the talent wear ungainly dangling earpieces, guzzle take-out coffee, and gnaw bagels on air. At times it's not entirely clear on these "diavlogs" whether Kaus has changed out of the sweatshirt he slept in the night before. "We wanted to distinguish this from what you see on TV," says the reliably deadpan Wright. "One way of driving the point home immediately is the fact we look like [expletive]."

Despite, or because of, these reasons, bloggingheads is great. It's smarter than the networks' Sunday morning talking-points recitations and more engaging than PBS' high-minded fare. What could be the future of political talk is so creaky and homemade it resembles public-access TV.

Bloggingheads' low-key political chat is sharp and surprisingly fun to watch

"The point is," says Kaus, "if I were having a phone conversation with Bob, this is what it would be like." That assumes that an hour-long phone conversation between old friends, which they are, meanders from the aftereffects of Abu Musab al-Zarqawi's death to Newt Gingrich's Presidential aspirations. What stops this from being a Web analog to Ambien is ...well, many things. It's actually funny, thanks to the rapport between the two men, which is apparent even when Kaus, not infrequently, ticks off Wright. (In one recent episode, a riled-up Wright sought to explain to Kaus "why you bring out the worst in me.") It also helps that they are both skilled debaters.

There is a phrase that describes what makes a hit on the Web, and that phrase is "weirdly compelling." No one could have imagined that looking at digital self-portraits online and posting comments under them was weirdly compelling until Friendster and then MySpace became two of the greatest venues for procrastination in the world since the Web itself. No one knew how weirdly compelling footage of people lip-synching could be until home videos of Gary Brolsma (the uninitiated can Google "numa numa") and two young Chinese men grimacing to the Backstreet Boys became huge Web hits. The same is true watching Wright get cranky whenever Kaus, in his well-honed contrarian shtick, contorts himself to find common ground with Ann Coulter. It turns out that the nontheatrical is theatrical, and a serious political conversation between two poorly dressed bloggers is, yes, weirdly compelling.

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JAMES C. COOPER

nflation Backs the Fed nto a Corner

nruly price indexes will trigger higher interest rates and new risks

U.S. ECONOMY It sure does look like a smoking gun. Up to now, an flation problem was hard to pin down, except at the gas pump. The lay consumer price index changed all that. It showed that inflation, ven outside of energy and some quirky readings on housing costs, is icking up much faster than almost anyone had expected a few nths ago. Most important, this new evidence changes : outlook for Federal Reserve policy and heightens the ks for the economy.

Rest assured, inflation is not about to rocket out of ntrol. Competition both at home and abroad is too stiff allow the kind of wage/price spiral that took off in the e 1960s. Businesses remain under intense pressure to earnings by controlling their costs, especially for or. And they are doing it with productivity gains, not simply jacking up prices.

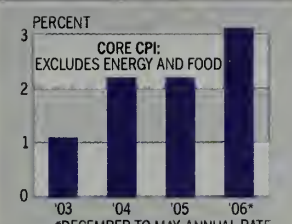
But the price indexes do show that the U.S. is more lation-prone now than it was during the inflation scare the late 1990s. Now, as then, U.S. labor markets are ht and capacity use is high. But this time, the global nomy is booming. That offers less of a safety valve for ce pressures, compared with the capacity glut outside e U.S. back then. Also, the dollar is still considerably ver now, meaning less restraint on import prices. The ggest difference is $70 per barrel oil, an enormous cost essure on many businesses.

May's consumer price index turned inflation worries o inflation reality. The core CPI, which excludes energy d food to capture inflation's broader trend, rose 0.3% m April. That was the third consecutive monthly vance of this size, which hasn't happened in more than lecade. Monthly increases of that magnitude are nificant, because if extended over a year, they would ld a 3.7% annual rate. As it stands, the 12-month rate core inflation in May was 2.4%, up from 2.1% in nuary, but the pace during the first five months of the ar has been far faster (chart).

HAT'S POTENTIALLY TROUBLING for the outlook is e Fed's response to all this. The Fed's goal has been to d the level of interest rates that will bring down the nomy's growth rate just enough to restrain inflation t not so much as to harm the economy. Economists call is manuever a soft landing, and the chances of pulling off had been looking good. Now, with inflation visibly celerating, the process could turn into a real nail-biter. ghten too little, and the economy and inflation keep aring. Tighten too much, and the economy crashes into ecession. History is a good guide here. If the Fed errs, it will be on the side of too much restraint, not too little.

That's especially true now. The Fed is not only battling inflation. Under new Chairman Ben S. Bernanke, it is also striving to maintain its credibility as an inflation fighter at a time when Wall Street needs reassuring. The Fed's favored inflation gauge is already exceeding the 1% to 2% comfort zone of several Fed officials, and recent economic data offer little assurance that the economy is slowing enough to vent growing inflation pressures. Policymakers are talking tough, and any failure to back up that talk with action would be viewed as backsliding.

INFLATION: MORE THAN A SCARE THIS TIME



Data: Bureau of Labor Statistics, Global Insight Inc.

Many Fed watchers who had thought the Fed would be finished hiking rates when its target rate hit the current 5% level are now lifting their forecast to 5.5%. Economists at Lehman Brothers, who expected the rate to top out at 5.5%, are now looking at 5.75%, and the research team at JPMorgan Chase has boosted its forecast to 6%. With the target rate already on the high side of neutral—the level that neither spurs nor restricts growth—policy will most likely be in the restrictive range this summer for the first time since the late 1990s.

SOME ANALYSTS ARE STARTING to worry that the Fed may end up overreacting. Much of the recent speedup has been due to rising housing costs, which may have more to do with how they are measured than an actual trend. The government uses changes in rents, instead of house prices and interest rates, as a proxy for the cost of homeownership. Rents have risen because more people are renting now that it's more difficult to afford a home. This measurement, though, gives the counterintuitive sense that housing costs are rising while the housing market is weakening.

But it's not just the housing quirk. So far this year, these rent-based housing costs are rising at a 4.6%

annual rate, up sharply from 2.5% for all of 2005. Because they account for a large 30% of the core CPI, they have contributed nearly 70% of this year's speedup in core inflation. Over the past three months these costs have risen even faster, but their contribution has been a smaller 58%. That means that since February, core inflation has picked up even outside of housing.

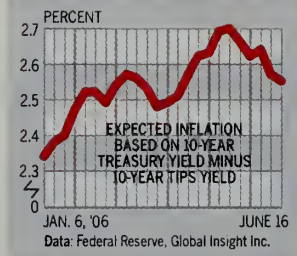
And it's not just the CPI. During the first five months of the year, the core producer price index for finished goods is rising at a 3.2% annual rate, more than twice as fast as the pace for all of 2005. Further back in the production pipeline, core prices for semi-finished goods have also accelerated. Even further back, costs of raw materials and supplies are up sharply. Prices of imported goods excluding fuels are increasing at a 3.2% rate, three times faster than last year.

PERHAPS MOST IMPORTANT, the Fed's preferred inflation gauge, the core price index for personal consumption expenditures (PCE), is also speeding up. This measure differs from the CPI in several ways, but the most important difference for now is that housing costs have a much smaller weight. Even if the core PCE index rises a modest 0.2% per month over the next three months, which is becoming an increasingly conservative scenario, the Fed's favored measure will show a 12-month rate of 2.5% by August. In February, the Fed's forecast for all of 2006 by this gauge called for core inflation of "about 2%."

One big plus for the Fed, so far, is that inflation expectations remain relatively low. If consumers and businesses start to build expectations of higher inflation into their buying and wage-setting decisions, then the classic wage/price spiral could take off.

Two key measures showed expected inflation coming down in June after picking up in April and May. The University of Michigan's June survey of consumer attitudes showed a decline in both short- and long-term expectations. Also, the spread between the yields on a 10-year Treasury note and a comparable Treasury inflation protected security (TIPS) has narrowed in recent weeks (chart). This spread remains in the narrow range it has been in for the past 2½ years.

INFLATION EXPECTATIONS TURNED DOWN IN JUNE



Data: Federal Reserve, Global Insight Inc.

Even so, keep in mind that people form expectations of inflation based on what is actually happening in the economy. That's why the pressure on the Fed to manage these expectations is increasingly heavy right now amid the new evidence that inflation is starting to accelerate. The Fed has little choice but to keep on raising interest rates until there are convincing signs that the economy is slowing down. That's the only way to assure that current inflation pressures will eventually recede.

MANUFACTURING

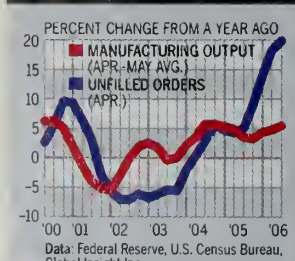
This Lull Shouldn't Last for Long

AT FIRST GLANCE, the unexpected decline in May's industrial output could be seen as evidence that softer economic growth has filtered down to the manufacturing sector. But factories still have a lot of unfilled orders to work through, and new demand should keep coming at a good clip.

Economists expected a modest rise in industrial output for May. Instead, the Federal Reserve reported that production eased 0.1%. The dip follows earlier news that factory payrolls fell in May and that new orders in April also retreated. What's more, the decline in industrial output was broad and not isolated to autos or home-related categories, such as appliances or furniture.

Yet there are plenty of other signs that indicate the recent patch of weaker factory data will prove to be temporary. So far in the second quarter, factory output is up 5.4% from the previous year, but unfilled orders have zoomed up nearly 20%. With the backlog of orders growing strongly, manufacturers will likely need to bump up production.

WHY FACTORIES WILL STAY BUSY



Data: Federal Reserve, U.S. Census Bureau, Global Insight Inc.

Investment spending should remain strong even if consumers become more frugal in response to high gas prices and a cooling housing market. Capacity utilization in mining and several durable goods industries, such as communications equipment, plastics, computers, and primary metals, were running quite high. And the Federal Reserve's Beige Book report on June 14 said that semiconductor manufacturers in the San Francisco Federal Reserve Bank's region are using 90% or more of their capacity. At such levels, more capital spending in those industries is likely.

Overall, the growth in output is set to outpace capacity gains for an eleventh consecutive quarter and is on track to widen for a third straight period. So far, second-quarter industrial capacity has grown just 2.4% from the year before.

The latest June regional factory activity reports from the Federal Reserve Banks of New York and Philadelphia show that demand in June probably accelerated. The new orders indexes from both surveys rebounded to levels comfortably above the long-term averages.

–By James Mehring in New Yo

NOVATIONS IN access

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The Business Week

News you need to know

EDITED BY HARRY MAURER

Telecom Titans Team Up **Siemens CEO Klaus Kleinfeld** once famously dunked a **Nokia** mobile phone in a glass of water in a show of contempt for his Finnish rival. Guess he won't be doing that anymore. On June 19, Siemens plugged almost all of its telecom equipment business into a joint venture with Nokia, creating a giant whose $20 billion in annual sales will allow it to compete with soon-to-merge **Alcatel** and **Lucent,** as well as Sweden's **Ericsson.**

The new entity, dubbed **Nokia Siemens Networks,** will have its home phone in Helsinki, and Nokia executives will dominate, a tacit acknowledgement that the Finns have proved to be more adept at dealing with the fast-moving telecom market. German commentators screamed that Kleinfeld is turning his back on Siemens' roots in communications, which date to the telegraph age. But Kleinfeld is obviously more concerned with reversing a recent history of lackluster profits. The duo plans to squeeze out $1.5 billion in costs, thus boosting their prospects in the critical Asian markets (Hangzhou photo, above). The move is also likely to speed the pace of hookups in the industry.

ONLINE *See "Siemens, Nokia point the way," www.businessweek.com/go/tbw*

Bill's Slow Fade Apparently ruling the software roost isn't that much fun anymore. **Bill Gates** announced on June 15 that he will ease away from his labors at **Microsoft** over the next two years and focus on his foundation.

See "After the icon exits," page 38,
ONLINE *and "Bill Gates's long goodbye," www.businessweek.com/go/tbw*

Airbus: More Flak Will a top gun go down in flames Production snafus on Airbus' new **A380** megaplane hav triggered a crisis at parent **EADS. Noël Forgeard,** the EAD co-CEO who ran Airbus until last year, is under pressure t resign as regulators probe his large sale of EADS shares i March. That was just before EADS says it learned of th A380 delays, which sent shares into a 26% tailspin whe the news came out this month. The stock fell again on Jun 21 on fears about political meddling, after **French Prime Mi ister Dominique de Villepin** suggested reexamining EADS shareholding structure, now carefully balanced betwee French and German interests.

The Housing Watch Everyone's nervously eyeing th housing sector, and it seems to be showing signs of lif The U.S. Census Bureau reported on June 20 that cor struction starts rose 5% in May. Then the Mortgag Bankers Assn. said on June 21 that applications for loar ticked up 0.1% in the week ended June 16. Alas, a couple numbers do not a rebound make. Economists figure th market has further to fall, pointing to higher interest rate and a growing inventory of unsold homes.

See "For sale, still," page 4
ONLINE *and "Beware false housing hopes," www.businessweek.com/go/tb*

Ronald Hits the Road in China How do you say "Tw Big Macs, and fill 'er up" in Mandarin? On June 20, **McDon ald's** and **Sinopec** unveiled plans to develop drive-throug restaurants at an undisclosed number of the energy compa ny's 30,000 gas stations on the mainland. Soaring Chines car ownership makes the drive-through format a no-brain for Mickey D's, which opened its first eatery in **Shenzhen** bac in 1990 and has roughly 750 in China now. The fast-food kin plans to add 250 outlets by the 2008 Beijing Olympics, an executives think the country could eventually support 10,00

New Bid for a Bourse **Deutsche Börse** may have scored goal into its own net and thus lost its match with the **NYSE** take over the **Euronext** exchange. In a rejiggered bid to assua French fears that Euronext would be crushed in a Teuton embrace, **Frankfurt** offered to share power with **Paris** and use French system to trade equities. Pols in its home state of **Hess** quickly waved a yellow card for foul play. **Premier Roland Koc** worried about Frankfurt's future as a financial center, called "a step too far." **Economy Minister Alois Rhiel** threatened a vet

Vonage vs. Verizon Poor Vonage. Shares of the Intern phone upstart have cratered by 48% since its May 24 IP Now investors have something new to sweat about: C June 20, Verizon said it has sued Vonage over allege patent violations. The telecom giant sportingly noted th it hasn't asked the courts to shut down its tiny rival, but may not have to bother. Analysts at Pyramid Researc questioned on June 20 whether Vonage, which is expecte to lose $330 million this year, is "toast." A Vonag spokesperson dismissed the complaint: "Instead of con peting against us in the marketplace, they sue us."

'hat's a Wetland? The Supreme Court muddied the ean Water Act on June 19 in a case that inspired three inions, none of which mustered a majority. Justice An- ony Kennedy delivered the deciding vote, directing a urt in Michigan to take a second look at its broad defini- n of a protected wetlands area. Kennedy wrote that only etlands with a "significant nexus" to a waterway deserve deral protection but left it up to regulators to figure out hat that means. The splintered opinion dismayed greens hile offering scant solace to developers, who predicted it ill give local projects little relief from oversight.

wallowing Jenny Craig Swiss food giant **Nestlé** ex- nded its waistline by announcing on June 19 that it ould buy weight-loss outfit Jenny Craig for $600 million m private equity firms **ACI Capital** and **MidOcean Partners.** raig, with some 600 weight-loss centers across the U.S., osted sales from $300 million four years ago to $430 illion last year. Nestlé, best known for chocolate, already vns the **Lean Cuisine** line. Weight loss is an ever-richer siness as the U.S. obesity epidemic worsens.

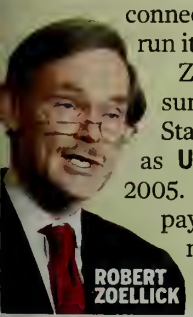
See "Nestlé: Fattening up on skinnier foods," page 48

lovies on iPod? Welcome to the mean streets of Holly- ood. After *Variety* reported on June 19 that **Steve Jobs** was lking with studios about downloading movies over **pple's** iTunes, Tinseltown brass held firm that they won't ake the same mistake as the music industry and let him ab their flicks cheaply. Studios want to charge $19.99 for new film, say insiders, whereas Jobs proposed $9.99, ar- uing that Hollywood needs to offer a killer deal to keep et users off piracy sites. The higher price would soothe VD retailers such as **Wal-Mart,** which charge around $20. 's called hardball, Steve. Maybe they'll do lunch.

ONLINE *See "Apple's iTunes movie muddle," www.businessweek.com/go/tbw*

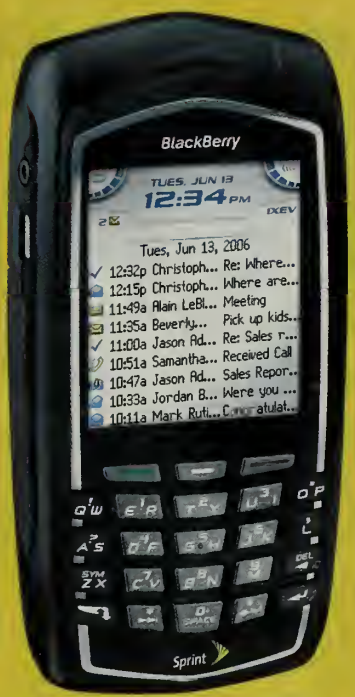
Second Career of the Week

If government were baseball, **Deputy Secretary of State Robert Zoellick** would be the player to be named later. On May 30, **President George W. Bush** tapped **Goldman Sachs CEO Henry Paulson** to be his next **Treasury Secretary.** On June 19, Zoellick, who wanted the top Treasury job himself, announced he was quitting the Administration—to join investment banking powerhouse Goldman as vice-chairman. It may not have been a trade, but Bush got a Wall Street heavyweight for Treasury, and Goldman got a well-connected expert in international finance to run its overseas banking operations.


ROBERT ZOELLICK

Zoellick, 52, has a long Washington résumé, including stints at Treasury and State under the first President Bush and as **U.S. Trade Representative** from 2001 to 2005. No word on how much Goldman will pay Zoellick, but he'll be making plenty more than Paulson, who is taking a $38 million cut to come to Washington.

Spend more time not wasting it.



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SCAMS

ID THEFT: MORE HYPE THAN HARM

Law enforcement officials say the criminals tend not to follow through after stealing personal data

BY DEAN FOUST

THE HEADLINES ARE enough to make you swear off eBay and lock your wallet in a safe-deposit box. Supposedly trustworthy companies like LexisNexis, Time Warner, ChoicePoint, and Wells Fargo, admit that the records of their customers or employees have fallen into the wrong hands. In one case, thieves break into a Midwest office of American International Group and steal a computer server containing personal data on 930,000 employees of companies seeking medical coverage. And in the Big Kahuna of identity theft, a laptop containing Social Security numbers and other sensitive information for nearly 29 million active and former military personnel is stolen from a Veterans' Affairs Dept. staffer's home in suburban Maryland.

All told, as many as 88 million Americans—more than one in four—had digital data exposed in the past 18 months. With each report, the feeling of helplessness grows. As George Anderson, a 74-year-old U.S. Navy vet and potential victim of the VA caper, puts it: "Here we go again."

But for all of the drama over ID theft, what is not often pointed out is how rarely it results in actual financial loss for consumers. There's reason to believe that the actual losses may be a little more than a tenth of the $48 billion annual estimate that often gets thrown around. In fact, at the same time that regular folks are getting the wits scared out of them about security breaches, experts in the field are growing less worried about the impact. Law enforcement officials, who braced for a wave of financial fraud following all those well-publicized incidents, admit they've been struck by the lack of follow-through by criminals. "What we've seen has not been significant," says Daniel Larkin, who heads the Internet Crime Complaint Center for the FBI. "Given the high profile, we would have expected to have seen more."

MEDIA FRENZY

WHAT GIVES? FOR ONE thing, it's not that easy to convert stolen data into dollars. The media frenzy surrounding each security breach has helped put consumers and merchants alike on the alert; once notified, many victims quickly get on the horn with their bank or credit-car company. Also, some of the purloine data from corporate and governmer computer systems are encrypted, pass word-protected, or at least require speci ic software to open. They aren't easily ac cessible. That appears to be the case wit the VA records, which officials have note were in a database format that would b hard to read.

Of course, anytime you lose your per sonal information to a stranger it fee like a big deal, regardless of how it's use You don't have to tell that to anyone wh has spent a day canceling credit cards having a driver's license replaced. And fo corporations, the ease with which crim nals and vandals can crack into the computer systems is hugely worrisom More than three-quarters of companie recently surveyed by Deloitte Touch Tohmatsu said they had suffered a secur ty breach from the outside, up sharp from the 26% that said they had suffere one when polled in 2005. But even fo companies, it's hard to find specific exan ples where hacking resulted in substa tial financial losses. "Theft of informatio is out of control, but use of that inform

O IN THIS SECTION:

Twentysomethings are starting hedge funds **38** What happens after iconic CEOs leave? **40** Nissan's risky move to Nashville **42** Housing is turning into a browser's market

> "What we've seen has not been significant. Given the high profile, we would have expected to see more."
>
> *–Dan Larkin, FBI*

tion to commit fraud is not out of control," says Avivah Litan, senior analyst at Gartner Inc., a research outfit based in Stamford, Conn.

BANKS BEAR THE BRUNT

THE TRUTH IS, IN the great majority of cases involving consumers, criminals don't have enough data with which to commit a crime. Consider the findings of a study conducted late last year by ID Analytics Inc., a San Diego firm that provides fraud detection services to a wide roster of clients, including six of the nation's 10 largest banks. ID Analytics analyzed four high-profile security breaches, which exposed the records of 500,000 consumers. (It declined to identify the companies involved, except to say they included two retailers and a bank.) Millions of transactions were examined for suspicious activity, using technology that can spot anomalies such as a Social Security number being used by more than one individual. ID Analytics concluded that the highest rate at which victims' personal data were misused in the four breaches it studied was just 0.09%, or roughly one in 1,020 individuals. Mike Cook, ID Analytics' co-founder, notes that rate lags far behind the 4% of Americans who said they had been the victim of financial fraud or identity theft in the latest survey by Javelin Strategy & Research.

If anyone were going to get hit, you would think it would be banks. They bear the brunt of most ID-theft losses, thanks to their "zero liability" policy of indemnifying holders of credit and debit cards. Yet card fraud not only hasn't risen in the past 10 years, but it's dropping. Jean Bruesewitz, senior vice-president of processing and emerging products for Visa USA Inc., notes that in relative terms fraud losses have declined sharply, from 19¢ for every $100 of credit-card spending in 1991 to just 7¢ per $100 of spending in the first quarter of this year. Bruesewitz estimates that no more than 2% of all credit-card and debit accounts exposed in a security breach have seen any unauthorized spending as a result.

One explanation is that banks have implemented sophisticated screening systems that can now monitor purchases and new account applications in real time. Visa has developed algorithms that provide its member banks with a rating of the odds that every individual transaction is fraudulent, based on a variety of criteria, including whether the account was among those exposed in a recent security breach, notes Bruesewitz. Similarly, MasterCard International nc employs technology that e ables its member banks spot questionable spendi patterns in time to decline t transactions.

Using that sort of sophis cated technology, MasterCa can compare purchases ma on one bank's card with oth transactions to spot broad patterns of criminal behavic Joshua L. Peirez, group exec tive in charge of global pub policy for MasterCard, not that some thieves establish bogus retai accounts and then try out credit-card nu bers by charging a nominal amount, t fore making bigger purchases. "We c now spot those type of transactions almc instantly," says Peirez.

As a result, some security experts qu tion whether actual losses from ident theft and financial fraud come anywhe close to the $48 billion in losses cited many media reports from a 2003 study the Federal Trade Commission based phone interviews with roughly 4,000 in viduals. To get that figure, the FTC simp toted up the number of individuals w said they suffered losses in the past ye multiplied that by the average of what th said they lost, and extrapolated for the U population. Fred H. Cate, a law profess and director of Indiana University's Cen for Applied Cybersecurity Research, no that if the estimate were accurate, it wou wipe out up to half of the banking indu try's $103 billion profits in 2005. "If thc numbers were true, we'd have a banki crisis on our hands," he says.

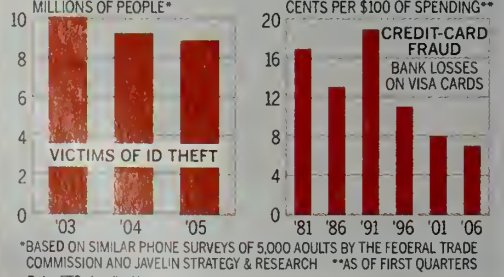
A more realistic figure for losses to ide tity theft and related fraud may be the $ billion that consumers say they lost ov the prior six months, according to a stu of 40,000 households conducted in t second half of 2004 and released this p April by the Bureau of Justice Statisti Most other studies of card fraud, includi an annual survey by *The Nilson Report*, p the bank industry's annual losses at abc $1.1 billion—a far cry from $48 billion.

Perhaps the most spooky thing abc the ID-theft scare is that chances are hi the data weren't stolen by some shado hacker in Estonia, after all, but someo very close to you. Fully one-fourth of t respondents in the 2003 FTC study w had been the victim of a financial fra said they knew who had committed t crime, and in half those instances the p petrator turned out to be a friend, relati or neighbor. ■

–With Sonja Ryst in New Yc

SAFER SELVES

Despite all the headlines, the number of self-described victims of ID theft and bank losses due to credit-card fraud have been dropping steadily



*BASED ON SIMILAR PHONE SURVEYS OF 5,000 AOULTS BY THE FEDERAL TRADE COMMISSION AND JAVELIN STRATEGY & RESEARCH **AS OF FIRST QUARTERS

Data: FTC, Javelin, Visa

/ALL STREET

HEDGE FUND TODDLERS

Vhy wait for that big break when you and few buds can manage millions now?

JUST THEIR OWN DOUGH Rebellion's Greenberg, Fleiss, Newton, and Sturges

Y ROBEN FARZAD

THE LIFE OF A TWENTY-something on a Wall Street trading desk can be miserable. If you're not slaving over a spreadsheet late into the night, your boss is whacking you on the head ith his BlackBerry for botching an options order. So it's no surprise that many eleaguered Gordon Gekko wannabes ntasize about running their own hedge und—and, oh yeah, collecting the standard 2% of assets and 20% of profits.

Used to be you had to spend 10 or more ears at the feet of a master before striking ut on your own. But nowadays some apprenticeships last only a few years. Even ids right out of college are giving it a try. arriers to entry are low, say experts, nough long-term success is another story. Opening a hedge fund is easy: It's just paerwork," says 30-year-old Jonathan Ioenig, managing partner at Chicago edge fund Capitalistpig Asset Management, which he founded in August, 2000, following a two-year stint as a futures trader at the Chicago Board of Trade (after dropping out of college). The tough part, Hoenig says, is raising money. After all, who in his right mind would entrust a million bucks to someone born during the third season of *Cheers*?

> "Opening a hedge fund is easy: It's just paperwork"
>
> *–Jonathan Hoenig, 30, managing partner, Capitalistpig Asset Management*

The fresh-faced men who run Rebellion Research Technologies, a Manhattan investment software shop, aren't daunted. "We are serious, experienced mathematicians," asserts 23-year-old Chief Executive and Co-Chairman Alexander C.E. Fleiss.

Fleiss partners with Spencer G. Greenberg, 23, a Columbia University grad, and two classmates from Amherst College, Jonathan K. Sturges, 23, and Jeremy C. Newton, 21. (Newton is still in school.) Forget Goldman Sachs; these guys say the finest pedigree is their mathematical model, a supersecret work of artificial intelligence refined over many nights and weekends. Already they're using it to manage their own money, generating returns "significantly above the market" and "with less risk," says Fleiss.

IT'S IN THE BLOOD

THAT'S NOT TO SAY Rebellion's founders know nothing about the inner workings of high finance. Fleiss's mother, Karen M. Fleiss, manages hedge fund KMF Partners. Alexander cut his teeth when, as a 19-year-old, he wrote a trading program that alerted him to the shares of a bankrupt leasing company that appeared undervalued. With money left to him by his grandfather, Fleiss accumulated so much of the 37¢ stock that he had to file an ownership statement with the Securities & Exchange Commission. The shares soared to $3.70, and Fleiss plowed his winnings into Rebellion. "You don't need a financial background," says co-Chairman and Chief Software Architect Greenberg, the son of Glenn Greenberg, manager of hedge fund Chieftain Capital Management. (Grandpa was baseball legend Hank Greenberg; grandma is a Gimbel's department-store heiress.) Spencer got his bachelor's in applied mathematics from Columbia last year.

Abiding by SEC rules, the Rebellion guys can't comment on whether their firm will morph into a hedge fund. "We would consider using our software to manage money at some point in the future" is all they will say. If and when that happens, investors' hunger for novel approaches just might get Rebellion face time with institutional power brokers. "They're looking for young, emerging managers," says Irwin M. Latner, a partner specializing in hedge funds at law firm Herrick Feinstein.

Still, most hedge fund aspirants have a little seasoning before setting up shop. One 29-year-old who got his MBA from a top B-school last year and is co-founding a fund has paid nearly a decade of dues, including a gig at an investment bank and junior roles at a small hedge fund and a large mutual fund. "Find me someone who buys the concept that merely going to a great school makes you a great investor," he sniffs, sounding like a grumpy old man.

SUCCESSION

AFTER THE ICON EXITS

How companies from Standard Oil to Wal-Mart have fared once their legendary chiefs moved on

BY JAY GREENE

WILLIAM H. GATES III has no confusion about his mythic stature in American business. When he announced plans in June to step away from Microsoft Corp., he acknowledged the importance of "getting beyond the myth of one person doing a high percentage of the things." He regularly invokes the federation of brilliant minds that make up the core of his company.

But Gates also knows how to play on his personal mythology. Interns swoon at the opportunity to go to a summer-ending barbecue at his mansion. Chief information officers leap at the chance for an audience, though it often ends with a sales pitch from Bill. Chinese President Hu Jintao made the pilgrimage to Redmond, Wash., in April just for the chance to dine with Gates. There's no question his departure from day-to-day business two years from now could leave a void.

History shows that a company with the right qualities can weather the passage of a mythic chief executive. It takes a coherent culture that propagates the wisdom of the founder. Senior executives must also understand what made the company great, and see how those lessons apply in a changing landscape. Here are some companies that have faced the challenge:

JOHN D. ROCKEFELLER
Standard Oil Co.
Like Gates, Rockefeller led a controversial business life, building a potent monopoly and becoming, for a time, the wealthiest man in the world. His reputation was bruised by run-ins with trustbusters, then burnished by outsize acts of philanthropy. Rockefeller left Standard Oil in 1897, handing the reins to John D. Archbold, who turned out to be even more confrontational. Archbold was combative with regulators. He made no friends in the press. When the government began considering the breakup of Standard Oil, the company had few allies to rally to its side. Perhaps Archbold's slickest move was to persuade Rockefeller to keep his retirement secret. That left Rockefeller to be blamed for many of Archbold's early missteps.

SAM WALTON
Wal-Mart Stores Inc.
As driven as they come, Walton perfected discount retailing with the zeal of a backcountry preacher. He started out running a store in Newport, Ark. By the time of his death in 1992, Wal-Mart was a goliath and Walton the world's richest man. His duties initially fell to his family, and then to David Glass, a finance executive who started at the company in 1976. While Glass lacked Walton's charisma, he made up for it with a knack for scaling up Wal-Mart. Discount retailing gave way to Wal-Mart's Supercenters, and Glass's bet on technology and logistics gave Wal-Mart an edge over rivals that it has yet to cede. In recent years, the retailing giant may have lost touch with customers to some degree. It is also struggling wit

SCORECARD

Sorting Out The Gates Legacy

The good, the bad, and the admirable after 31 years at the top

BY STEVE HAMM

In 31 years atop Microsoft, Bill Gates was revered by some and loathed by others. He was a primary architect of the PC industry. Yet he'll be remembered as much for bare-knuckle tactics—and an antitrust judgment for anticompetitive behavior—than for tech breakthroughs. So Gates enters this next phase with his legacy in the balance. He could go down as an Andrew Carnegie, who is remembered as a generous benefactor in spite of sometimes brutal treatment of workers; or as a John D. Rockefeller, whose Robber Baron image stuck despite later good works. Here's Gates, by the numbers.

1.75 Billion PCs Sold

The success of Microsoft DOS, and, later, Windows, helped the PC spread to business and homes, empowering office workers and consumers alike. By the count of market researcher Gartner Inc., 1.75 billion Microsoft-powered PCs have been sold since 1981. And consider the even bigger picture: Economists estimate that all information technology, including PCs, contributed about one-third of the 2% average annual U.S. productivity growth since 1995.

ldresses employees at a Seattle baseball stadium

estions about its labor practices, and e sprawl that its stores create. But many those complaints date back to Walton's me and can't be blamed entirely on the ccession.

AKIO MORITA
Sony Corp.
The irrepressible co-founder of Sony built the company into a global power by combining clever products, innovative design, and potent brand marketing. A stroke disabled Morita in 1993. His duties shifted to Norio Ohga, and then to Nobuyuki Idei, whose tenure is better remembered for failed restructurings than brilliant product launches. Morita might not have done any better. He barely had a chance to glimpse the wave of globalization that ultimately crushed Idei. Once rivals such as Samsung, Nokia, and Microsoft hit their stride in the consumer electronics markets where Sony shined, even Morita's energy and talent might not have been enough to assure clear sailing.

HERBERT D. KELLEHER
Southwest Airlines Co.
Although born in New Jersey, Kelleher embodies the Texas persona that came to define Southwest. He's a hard-charging good ol' boy who revolutionized the modern airline business. He created a corporate culture where employees, including Kelleher, poked fun at themselves. It was a sea change for the airlines, whose leaders often came from the military and infused the system with a stifling bureaucracy. More important, he helped democratize air travel, figuring out a way to offer it cheaply to the masses. The secret was using just one type of jet, Boeing's 737. He offered no meals and no first class. And employees pitched in on tasks outside their job descriptions, making the airline more efficient. Southwest has continued to thrive since Kelleher handed over duties to his hand-picked successors, President Colleen C. Barrett and CEO Gary C. Kelly, because they, too, grew up in the culture of employee focus and operational discipline. And they're intent on maintaining it.

ANDREW S. GROVE
Intel Corp.
Grove replaced another legendary CEO, Gordon E. Moore, who predicted the speed with which chips would increase their processing power, creating a time line for the computer industry as a whole. There's no Grove's Law. But the driven, quick-tempered Grove, who escaped from his native Hungary during the 1956 revolution, turned Intel from a money-losing chipmaker into the world's dominant microprocessor company by focusing on manufacturing efficiency. Grove neatly sidestepped the very same type of antitrust battles with regulators that have dogged Microsoft. In 1998 he turned the CEO duties over to Craig R. Barrett, a longtime protégé who lacked Grove's charisma. Barrett largely failed to break Intel out of its PC mold, and his successor, Paul S. Otellini, is now struggling to keep Intel relevant in the Internet Age, where the PC plays only a supporting role.

–With Peter Coy and James E. Ellis in New York, Robert Berner in Chicago, and Cliff Edwards in San Mateo, Calif.

$88 Billion Cumulative Profits

's greatest legacy may be the creation of h, both his own and others'. Microsoft ned out $88 billion in profits since 1985, sucked from customer pockets as ents on his monopolies in PC software. drove up the company's stock price, hing Gates and other insiders, who held of the shares in late 1999. But Microsoft minted, by some estimates, thousands of employee-millionaires, maybe the most y company ever.

$375 Billion Lost Market Cap

By 2000, a broad swath of American investors owned a chunk of Microsoft shares, directly or in mutual funds or retirement plans. Unfortunately for those individuals, that's when the air began to leak out of the balloon. Microsoft's stock market value peaked on Dec. 27, 1999, at $600 billion. Since then, the stock has lost more than 60% of its value. Insiders sold aggressively, bringing their share of the company to 14% last year (9.5% for Gates personally).

118 Million Children Immunized

Through the Bill & Melinda Gates Foundation and its $29 billion endowment, Gates aims to improve health and education and reduce poverty worldwide. The $1.5 billion he has given to immunize poor children has already helped avert an estimated 1.7 million deaths. Gates will soon be working full-time for the foundation. Look at it this way: Gates's monopoly made him fabulously wealthy. But if he thrives as a philanthropist, at least his customers' money will be well spent.

(TOP CENTER) ANTONIN KRATOCHVIL/VII; (SMALL PHOTOS CLOCKWISE FROM LEFT) GENERAL PHOTOGRAPHIC AGENCY/GETTY IMAGES; ROB NELSON/TIME LIFE PICTURES/GETTY IMAGES; AFP/GETTY IMAGES; ANNE KNUDSEN/GETTY IMAGES; TIM SHARP/AP/WIDE WORLD; GRAPHICS BY ALBERTO MENA/BW

RISKY BUSINESS Ghosn must get four models out the door while dealing with an exodus of talent

AUTOS

NISSAN'S LONG HAUL TO NASHVILLE

Is the eve of a new product line the best time for a disruptive cross-country move?

BY DAVID WELCH

CARLOS GHOSN ISN'T just a turnaround artist. He's also the auto industry's most brazen daredevil. Taking the wheel of Nissan Motor Co. in 1999 was the definition of gutsy; the company lost $6.5 billion that year and had amassed $20 billion of debt. Yet Ghosn set targets that made the hucksterish Lee Iacocca look reserved. Within three years, Ghosn vowed, Nissan would make money and have half as much debt. After hitting those goals early, he swore to boost sales by 1 million cars, pay off all debt, and post industry-best margins. He did that, too.

Now, with Nissan's U.S. sales slumping, the Renault-Nissan boss is again pedal to the metal. Even as Nissan gears up to launch four models that Ghosn hopes will rev up sales, he has the company moving its North American headquarters from Los Angeles to suburban Nashville, where Nissan has a factory. Ghosn aims to save money and juice creativity by putting his team under one roof.

But the relocation has roiled the company. More than half of his 1,300 U.S. white-collar staffers have quit over the move—and some were instrumental in the turnaround. Now Ghosn needs to hire hundreds of people, train them, and launch four vehicles—all in four months. "There's never a good time for a move," Ghosn admits. "[But] if I didn't have a big challenge, then I'm not stretching the company."

Well, he's got one. After years of racking up solid sales growth in the U.S., Nissan is starting to lose momentum. U.S. sales were off 3% as of May. Meanwhile, Toyota Motor Corp. and Honda Motor Co. each were up almost 9%. To whet buyers' appetites, Nissan needs new product—both to replace aging models and enter the growing subcompact market. And that's where the quartet of new cars comes in. Starting in July, the auto maker will launch the new Versa subcompact, followed by the Sentra compact, Altima sedan, and Infiniti G35 luxury sedan.

BLOGGERS' ANGST

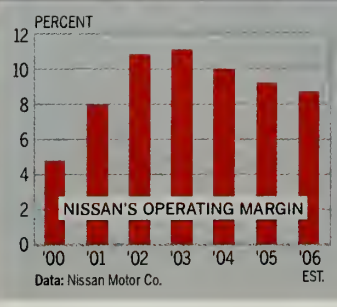
AS USUAL, GHOSN has outsize ambitions for the new models: He expects them to help Nissan rekindle the 60% sales growth of the past six years. He also says they'll be key to increasing global volume from 3.6 million vehicles now to 4.2 million in two years. He told *BusinessWeek* that come October, when the first of the cars will be launched, profits and sales will turn up again. As early as September, he says, the move will be but a memory.

That's a big maybe. On learning of the relocation, some staffers were so ticked off they went on Nissan's blog to accuse James C. Morton Jr., senior vice-president for finance and administration, of pushing the move to further his agenda. They said the active Republican had political aspirations that were more easily realized in red state Tennessee than on the Left Coast. Morton denies it. "I'm looking forward to getting back to the South," he says. "But I have no intention of running for public office."

Some executives simply thought the move to Tennessee was a bad idea. So the company hired Boston Consulting Group to figure out if the juice was worth the squeeze. Morton says the study affirmed both cost savings and the cross-fertilizing benefits of bringing

NISSAN 2007 SENTRA

LOSING MOMENTUM



Data: Nissan Motor Co.

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managers of different disciplines together. But it also warned of losing staff and straying from Southern California—ground zero for American car culture.

And there's no getting around the fact that the loss of some top U.S. executives could hurt the rollout of the four cars and, longer term, Nissan's ability to keep coming up with hot models. Sending a new car to market is something of a black art in the best of times, let alone when newbies are replacing veterans. Auto makers need to make sure they have the selection of options that consumers want. The correct mix of cars and trucks, with all their different configurations and paint colors, must be sent to regions where they're most in demand. Finally, the marketing guys need to settle on an ideal blend of national and local advertising to cut through the clutter.

Nissan has lost nearly 60% of its U.S. salaried workforce

John E. "Jed" Connelly, senior vice-president for sales and marketing, and his team were very good at all of that. And he's leaving. So, too, is Jack C. Collins, vice-president for product planning, who played a big role in engineering Nissan's turnaround by cranking out tasty street candy. Seven of Nissan's top nine product planners have also left. "Nissan has to recreate the organization," says Jim San Fillippo of Automotive Marketing Consultants Inc. "They lost a huge amount of talent."

Also, let's not forget that the last time Nissan tried to do so much, it stumbled. In 2003 it opened a factory in Canton, Miss., to build large pickups, SUVs, and minivans that it had never made before. Ghosn and his team swore building newly minted vehicles in a virgin plant with an upstart workforce and a new chain of suppliers was doable. But quality problems plagued the trucks and the minivan. *Consumer Reports* rates Nissan's large SUVs among the worst cars on the market for reliability.

It's true that Nissan has already decided what cars it will launch over the next two years. And many of the talented ex-employees left their imprimatur on them. Still, the new organization will have to pick up where the current team left off. Ghosn, naturally, professes himself undeterred. Says the Brazilian-born Frenchman: "Judge this move one, two, or five years down the road."

UNREAL ESTATE

FOR SALE, STILL

Housing is turning into a browser's market

BY PETER COY

SELLING A HOME? GOOD luck. The market continues to soften despite recent reports that seem to hint at signs of life. Brokers and builders say buyers are on hold, waiting to see if they can cut a better deal. "I am exhausting myself taking buyers out. I cannot get them to commit," gripes a real estate agent in Westchester County, N.Y., where the number of unsold homes rose 38% in the first quarter from a year earlier.

The positive news has to do with housing starts and mortgage applications. On June 20, the Census Bureau said the number of homes on which construction began rose 5%, seasonally adjusted, from April to May. The next day, the Mortgage Bankers Assn. reported a 0.1% increase in weekly applications for mortgages to buy homes—not a big increase, but better than the decline many analysts expected.

Trouble is, the housing starts number was inflated by comparison with a weak April, when bad weather slowed builders. Permits in May fell 2.1% from April, and 8.5% from a year earlier. The mortgage increase was harder to explain away since applications have basically plateaued since February. But economists say the number is bound to fall, given rising mortgage rates and a growing overhang of unsold homes.

HOUSIN WATC

Housing optimists argue that the market is merely settling back to a sustainable pace from an unsustainable boom. "Two or three years ago we would have been killing for this kind of a market," says Thomas R. Kuntz, CEO of Century 21 Real Estate.

But as the housing market continues to soften, more participants are having trouble putting the best face on things. The confidence of builders in June hit its lowest level since April 1995, said the National Association of Home Builders on June 19. Investors are heading for the exits: Stocks of the biggest builders are down by a third to a half since their peak last summer.

The change in attitude is most pronounced in areas that until recently were superheated, such as Southern Florida. "Sellers are desperate," says broker Mike Morgan, owner of Morgan Florida in Stuart, Fla. He says that home builders there are paying him commissions of 6% to 10% to steer customers their way as they compete for scarce buyers. "I've never seen anything like it."

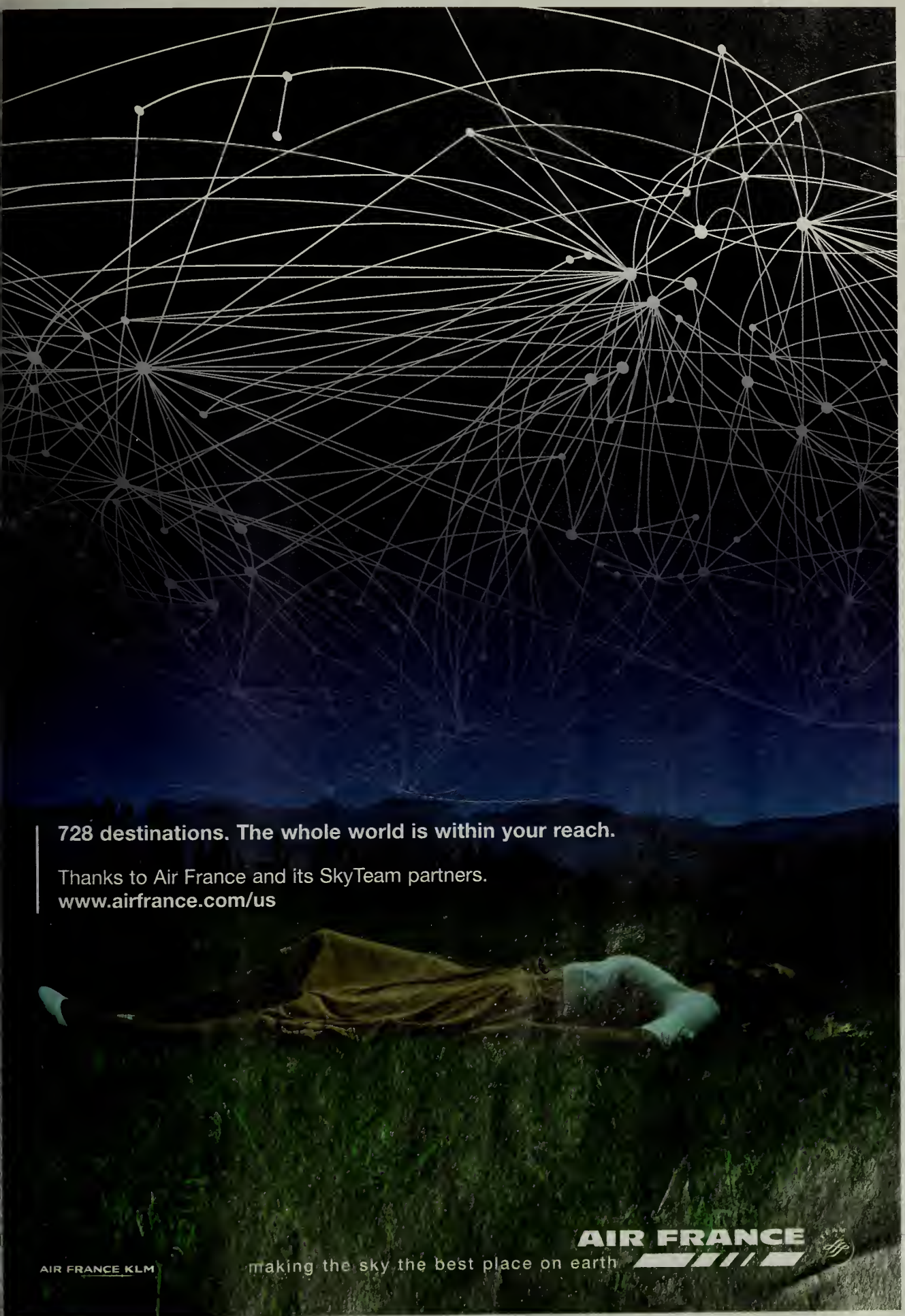
A slowdown could crimp the nation's economy even if prices don't fall nationally. Housing—from carpentry to brokering to sales of dishwashers for new homes—has accounted for about 8% of gross domestic product recently, says High Frequency Economics, a Valhalla, N.Y., research firm. If the sector falls back to its normal share of 3.5% of GDP over the next year, it could subtract enough growth to put the economy into a mild recession by early 2007, the bearish firm says.

THE STAT

8.5%

One-year decline in permits for home construction, through May

Data: U.S. Census Bureau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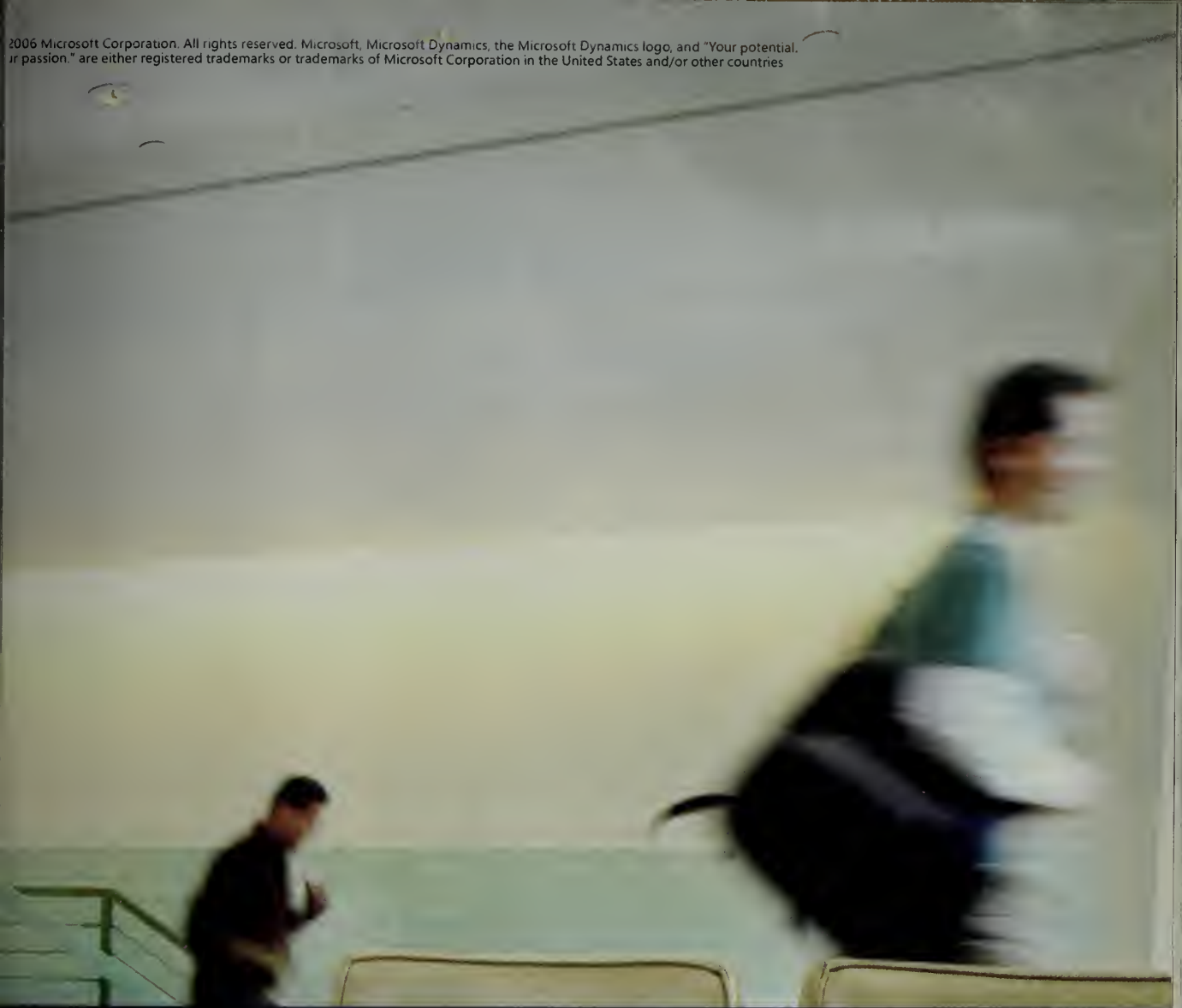

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INNOVATION

CAMP SAMSUNG

To develop winning products, the Korean giant isolates artists and techies for months on end

BY MOON IHLWAN

LAST JUNE A GROUP OF 11 Samsung Electronics Co. employees pledged to do the last thing most people desire just as spring bursts into summer: stay inside a drab room with small, curtained windows for the bulk of the next six weeks. The product planners, designers, programmers, and engineers had recently entered Samsung's so-called Value Innovation Program (VIP) Center, just south of Seoul. They were asked to outline the features and design of the company's mainstay flat-screen TV, code-named Bordeaux. And their bosses had vowed to keep them posted there until they had completed the assignment.

After an introductory ceremony attended by senior executives of Samsung's video division, the team joined a dozen or so similar groups at the VIP Center and got down to work. The facility is a sort of boiler room where people from across the company brainstorm day after day—and often through the night. Guided by one of 50 "value innovation specialists," they study what rivals are offering, examine endless data on suppliers, components, and costs, and argue over designs and technologies. The Bordeaux team hammered out the basic look, feel, and features of the model by mid-August. Then over the next five months designers and engineers worked out the details, and by February the sets were rolling off Samsung assembly lines. They hit stores in the U.S. and South Korea this April, starting at about $1,300 for a 26-inch set. "For the first time in our company, we developed a TV appealing to customers' lifestyles," says Kim Min Suk, an official at Samsung's LCD TV Product Planning Group.

It's all part of a new mantra at Samsung: "market-driven change." In the past decade Samsung has radically improved the quality and design of its products. Yun Jong Yong, Samsung's 62-year-old chief executive, now wants the company to rival the likes of Microsoft Corp. and IBM as a key shaper of information technology. By 2010 he aims to double sales, from $85 billion last year to $170 billion. The Korean giant, however, still isn't an innovation leader on the order of Apple Computer Inc. or Sony Corp. in its heyday. Yun says Samsung has become "a good company," but "we still have a lot of things to do before we're a great company."

Yun insists that when it comes to manufacturing, his company is second to none. Yet in the Digital Age, when me

PLAYBOOK: BEST-PRACTICE IDEAS

Brainstorming ABCs

A key weapon in Samsung's success is the Value Innovation Program (VIP) Center, where the company's brightest lights dream up must-have products or streamline operations to trim costs. Here's how they do it:

LOCK 'EM UP

Daily routines can interrupt the flow of great ideas, so Samsung isolates its development teams in the VIP Center—and requires all members to work there for weeks on end, until the project is completed.

GUIDING HAND

Some 50 specialists work at the Center, helping teams stay focused on the problems at hand, develop various alternative solutions, and reach a consensus when it's time to make a decision.

MIX 'EM UP

Brainstorming is most successful when a wide variety of viewpoints is represented. So Samsung gathers teams of engineers, designers, and planners from across the company to develop new products.

SET A DATE

Deadlines force teams to make tough choices and overcome disagreements that can slow down progress. Each team is given a timetable for progress and a fixed date for the project's completion.

DO THE MATH

Team members draw "value curves," graphs that rank attributes such as a product's sound or picture quality on a scale from 1 to 5. These help the team set priorities and differentiate Samsung's products from rivals'.

TOGETHERNESS
Group bathing at Samsung's innovation center

nical parts are replaced by chips, Sam-ıg's well-run factories are no longer ɔugh to make it stand out. He points to 3 players as an example. Samsung ed out its first players two years before ple did. But Apple gave consumers the mate player—the iPod—and, with the nes software and Web site, an easy y to fill it with music. It's time for Sam-ıg to start developing similar products, ı says, that better serve customers. So , "we don't have the power to deliver al solutions."

CUBATION STAGE

W TO MAKE SAMSUNG more innova-e? One key initiative is the VIP Center. ı set up the program in 1998 after con-ding that as much as 80% of cost and ality is determined in the initial stages product development. By bringing to-her everyone at the very beginning to ash out differences, he believed, the mpany could streamline its operations d make better gadgets. In the past two ırs, though, the center's primary aim s shifted to "creating new value for cus-ners," says Vice-President Lee Dong , who heads the facility. Translation: ıd that perfect balance of cost, innova-n, and technology that makes a prod-great.

If it weren't such hard work, it might nost be fun. The center, at Suwon, Sam-ıg's main manufacturing site, 20 miles from Seoul, is open 24 hours a day. Housed in a five-story former dormitory, it has 20 project rooms, 38 bedrooms for those who need to spend the night, a kitchen, a gym, traditional baths, and Ping-Pong and pool tables. Last year some 2,000 employees cycled through, completing 90 projects with names such as Rainbow, Rapido, and Rocky. Other products that have come out of the center include a notebook computer that doubles as a mobile TV, yet is thin and light enough to be carried in a handbag, and the CLP-500, a color laser printer that was built at the same cost as a black-and-white model. While some teams wrap up their work within weeks, other projects drag on for months, and all division leaders sign a pledge that participants won't return to their regular jobs until they have finished the project.

Workers pledge to stay involved in the project till it's finished

The Bordeaux team shows how the VIP Center works. The goal was to create a flat-screen TV that would sell at least 1 million units. But the team members quickly discovered that they had strongly differing opinions about what consumers want in a TV. The designers proposed a sleek, heavily sculpted model. Engineers wanted to pack in plenty of functions and the best picture and sound quality. Product planners were concerned primarily with creating something that would beat the offerings of Sharp Corp., then the leader in LCD TVs.

Every step of the way, team members drew what Samsung calls "value curves." These are graphs that rank various attributes such as picture quality and design on a scale of 1 to 5, from outright bad to excellent. The graphs compared the proposed model with those of rival products and Samsung's existing TVs. The VIP Center specialists also guided the team in discussions exploring ideas and concepts from entirely different industries, picking up hints about the importance of the emotional appeal in the offerings of furniture makers and Hollywood. "We wanted a curve resembling a wine glass, and a glossy back to make the TV fit in with other furniture," says designer Lee Seung Ho, who worked on the Bordeaux project.

One challenge the team faced: Surveys showed that shoppers buy a flat-screen TV

BusinessWeek online For a slide show on Samsung's VIP Center, please visit www.businessweek.com/extras

as much for its look as a piece of furniture as for its technological muscle. Some members went to furniture stores to figure out what made buyers tick, and discovered that the design of the set trumps most other considerations. So the group started shedding function in favor of form, cutting corners on high-tech features to spend more to make a TV that looks good even when it's turned off. The control buttons were placed out of sight on the side, while the speakers were tucked under the screen to create a sleek, minimalist front underlined by a flat, curving V in blue or burgundy. The back and stand got the same high-gloss coating as the front. To keep costs down (part of that quest for value), Samsung removed a sensor that automatically adjusts the brightness to the light in the room and decided not to boost resolution to accommodate the latest high-definition standards. And with the speakers under the screen, the sound quality was lowered even as the TV's silhouette improved. "We tried to make sure consumers get maximum value for an affordable price," says Kim Dong Joon, one of several senior managers at the VIP center.

Samsung has edged out Sony in U.S. sales of LCD TVs

The initial response is encouraging. In the last week of May, Samsung inched ahead of Sony to become the No. 1 LCD TV brand in the U.S., garnering market share (in terms of value) of 26.4%, compared with Sony's 24.6% and Sharp's 8.2%, according to researcher NPD Group. In January, Samsung was No. 3, with just 12.1%. Yun now says he wants to become the top maker of digital TVs, including those using plasma and rear-projection technologies, in the U.S. this year.

Pretty grand ambitions. But Yun has a strong record of setting stretch goals and achieving them. Under his stewardship, Samsung has transformed itself from an industry also-ran into the richest electronics maker in Asia. Now it could also become the coolest if Yun can reinvent Samsung one more time and get his engineers, designers, and marketers to dream up products such as the Bordeaux and really fire consumers' imaginations. It just might mean spending the summer inside. ■

HONG KONG Nutren Balance bars are aimed at diabetics

NUTRITION

NESTLE: FATTENING UP ON SKINNIER FOODS

It sees hefty profits in offerings that fight diabetes and slim the waistline

BY CAROL MATLACK

N-E-S-T-L-É-S. NESTLÉ'S makes the very best... health food? The world's biggest food company, best known for its chocolate and coffee, has embarked on a new push to tackle obesity and diabetes. At the company's mountainside research laboratory near Lausanne, Switzerland, scientists are working on new products that alter the body's absorption of sugar, reduce fatty acids in the bloodstream, and step up the burning of carbohydrates during digestion. The first of these offerings, a cereal bar with a fiber additive that tamps down surges in blood sugar levels after eating, was launched in Asia last year and will soon be rolled out worldwide.

For now, the cereal bar is markete mainly to people with type 2 diabete which is often triggered by obesity. B Nestlé says the same additive could lat find its way into mass-market brand such as Stouffer's and Lean Cuisine pr pared meals. And with more than 30 million obese people worldwide, inclu ing 30% of U.S. adults, it's easy to u derstand Nestlé's interest in the marke "Our entire sector is starting to migra to healthier choices," says Richard Laube, chief executive of Nestlé's nutr tion division. As part of that trend, Nest announced on June 19 that it would pa $600 million for Jenny Craig Inc., Carlsbad (Calif.) company that sells pr pared diet foods and operates 60 weight-loss centers across the U.S.

The Jenny Craig deal gives Nestlé boost in the booming diet market. B

SUB-ASSEMBLIES
IN MILAN

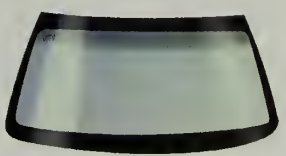
AIR IMPORTS
FROM JAPAN

AIR IMPORTS
FROM AUSTRALIA

WAREHOUSE MANAGEMENT
IN KANSAS CITY, MISSOURI

CUSTOMS BROKERAGE
IN ROTTERDAM

JIT DELIVERY
FROM JUAREZ, MEXICO



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ISTRIBUTION TRANSPORTATION SUPPLY CHAIN TECHNOLOGY SOLUTIONS GLOBAL SOLUTIONS

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SMART CHOICE

the newfangled products that Nestlé's scientists are whipping up may prove far more lucrative in the long run. Some 171 million people worldwide suffer from type 2 diabetes, and 80% of them are obese. As obesity rates continue to rise, the number of diabetics worldwide is expected to double within 25 years.

Nestlé has patented technologies to alter natural fats and fibers

Foodmakers have long tinkered with recipes to reduce sugar and fat and have pumped in "healthy" extras, from oat bran to olive oil. The track record isn't encouraging. Obesity has soared even as low-sugar, low-fat, and low-carb foods have proliferated. But now the industry is pushing into new territory. Nestlé and other companies are patenting technologies that alter naturally occurring fats and fibers. And they're carrying out medically supervised tests on humans, in much the same way pharmaceutical companies conduct drug trials. Their goal: to develop products that change the way food is digested, thus "tricking" the body into feeling less hungry.

A shelf full of foods that fight obesity and diabetes would be a marketing dream come true. Market researcher ACNielsen says products billed as "healthy" account for 18 of the 24 fastest-growing food and beverage categories. Worldwide, sales of granola bars rose 14% last year, compared with only 4% growth for chocolate confectionery. What's more, foods that claim specific health benefits typically generate operating margins above 15%, compared with 9% to 12% for more conventional processed foods. "'Healthy food' undeniably is a key growth engine," says Arnaud Langlois, a London-based analyst with JPMorgan.

Nestlé's latest push in this direction began in 2002, when it assigned scientists to study the molecular mechanisms that lead to weight gain and diabetes. The first product to emerge is the cereal bar for diabetics, currently sold only in Asia under the brand name Nutren Balance. The bar contains beta-glucan, a fiber occurring naturally in oats and barley that slows the body's absorption of starches, reducing the risk of surges in blood sugar that are dangerous for diabetics. Nestlé developed a patented method to triple the level of beta-glucan in oats, while altering the fiber so it becomes more viscous in the stomach. That slows digestion and creates a sense of fullness.

More engineered foods are on the horizon. Nestlé is studying acetogenic fibers, something found in apples and some vegetables that may reduce high levels of fatty acids in the bloodstream, which appear to trigger diabetes. Researchers recently completed a six-week study in which people with early symptoms of diabetes drank a beverage containing acetogenic fibers, while a control group was given a placebo. The results haven't yet been published, but "if the science works, this could be our next product," says Catherine Macé, a biologist at Nestlé's.

Nestlé's rivals are scrambling to develop such foods, too. Anglo-Dutch Unilever Group has developed a process to alter the molecular structure of fat-containing emulsions, so the intestine absorbs fat more slowly, delaying hunger pangs. The new emulsions have been used in Unilever's Slim-Fast Optima diet shakes since early this year and may eventually turn up in Unilever ice creams and beverages. Paris-based Danone recently launched a yogurt calle Saciactiv, which contains a modified fib additive. The fiber prompts the stomac to release hormones that Danone say produce a feeling of fullness.

"JUST A PLOY"

ALL THIS SOUNDS promising, but so d some earlier products that ultimate flopped. Remember Olestra? Procter Gamble Co., after much marketin hoopla in the 1990s, had to eat crow whe the fat substitute gave consumers ston ach pains and worse. Even after the U. Food & Drug Administration in 2003 lif ed a requirement for warning labels, fe foodmakers embraced Olestra.

That's why many cri ics remain skeptical the foodmakers' late efforts. "This is just marketing ploy," sa Marion Nestle (no rel tion to the company chairman of New Yo University's Depar ment of Nutrition, Foo Studies & Public Healt "If you give these thin to people under lab co ditions, they lo weight," she says. "B let them loose in restaurant, and th compensate."

Food companies a knowledge that an ir proved overall diet ar exercise are the on sure ways to lo weight. "We don't b lieve there's any kind magic product," sa Moïse Riboh, direct of strategic planning Danone.

Because Nestlé's new cereal bar ta gets diabetics, the company will see FDA approval. But if they don't promi to treat a specific ailment, compani don't have to seek the agency's O. Danone recently launched a yogu called Activia in the U.S. that promis to improve intestinal regularity. Y since its ads don't mention constipatio it doesn't require a nod from the FDA

The latest generation of engineer foods won't cure obesity and diabetes. fact, it could turn out to be just anoth chapter in the sad history of health-fo fads and failures. But with waistlines st expanding worldwide, food manufactu ers are ready to exploit the trend and fa ten their bottom lines. ■

From Petri Dish to Dinner Plate

PRODUCT	MAKER	HOW IT WORKS
NUTREN BALANCE Cereal bar for diabetics	Nestlé	An enhanced, high-fiber additive reduces swings in blood-sugar levels by slowing absorption of glucose
SLIM-FAST OPTIMA Shakes	Unilever	Altered emulsion slows fat absorption in the intestine to reduce hunger pangs
SACIACTIV Yogurt	Danone	Fiber additive triggers release of hormones in stomach to increase feeling of fullness

Data: *BusinessWeek*

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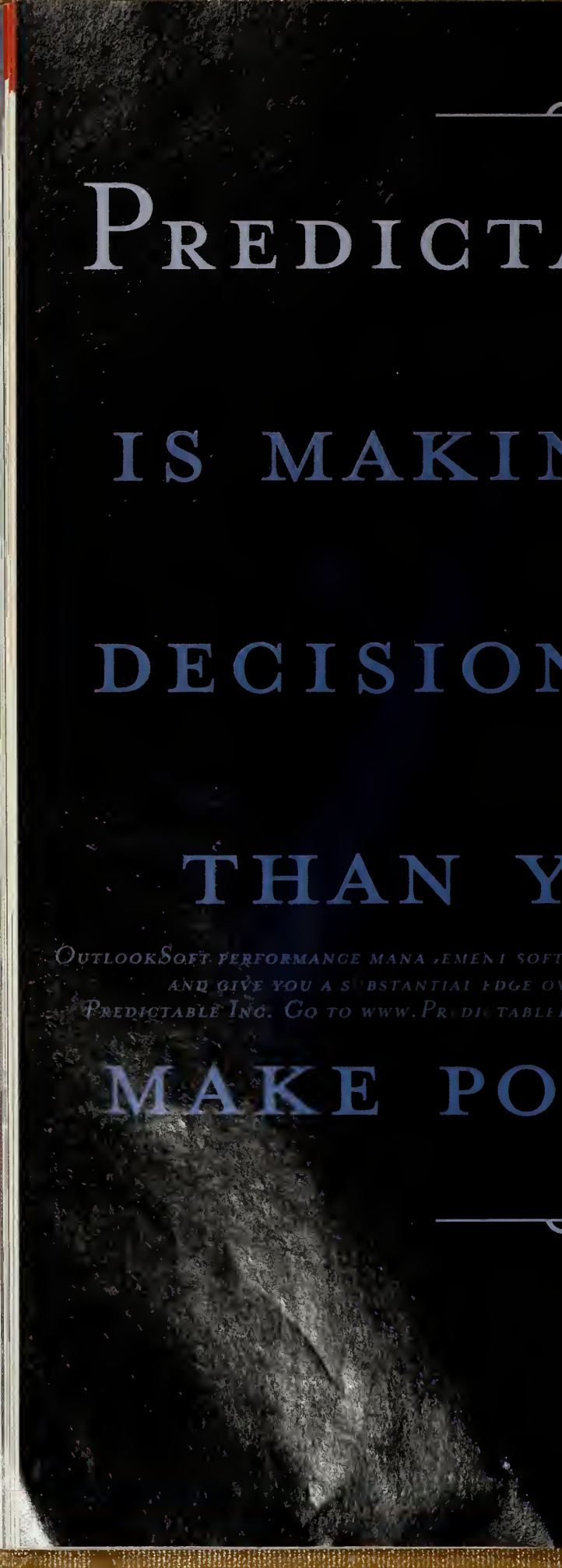

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Inside Nathan Myhrvold's Mysterious New Idea Machine

As his cash-rich firm snaps up thousands of patents, fears emerge that it will become a leader in litigation —not innovation. By Michael Orey

A ROCKET SCIENTIST, A MATHEMATICIAN, a brain surgeon, and a lawyer walk into a room. It sounds like the beginning of a joke, but at Intellectual Ventures it's something more serious—a business model. IV traffics in a single product: invention. On June 17 it invited 10 of the most blindingly brilliant doctors and scientists in the country to a daylong brainstorming session at its headquarters in a nondescript office building next to a swamp in Bellevue, Wash. Assembling around a conference table, the diverse group, which included physicists from Lawrence Livermore National Laboratories, physicians from several major medical centers, and a Stanford University postdoctoral fellow in bioengineering, spent the day pondering a complex question: How can surgery be improved? The goal wasn't just incremental advances but multibillion-dollar lightning bolts that could change

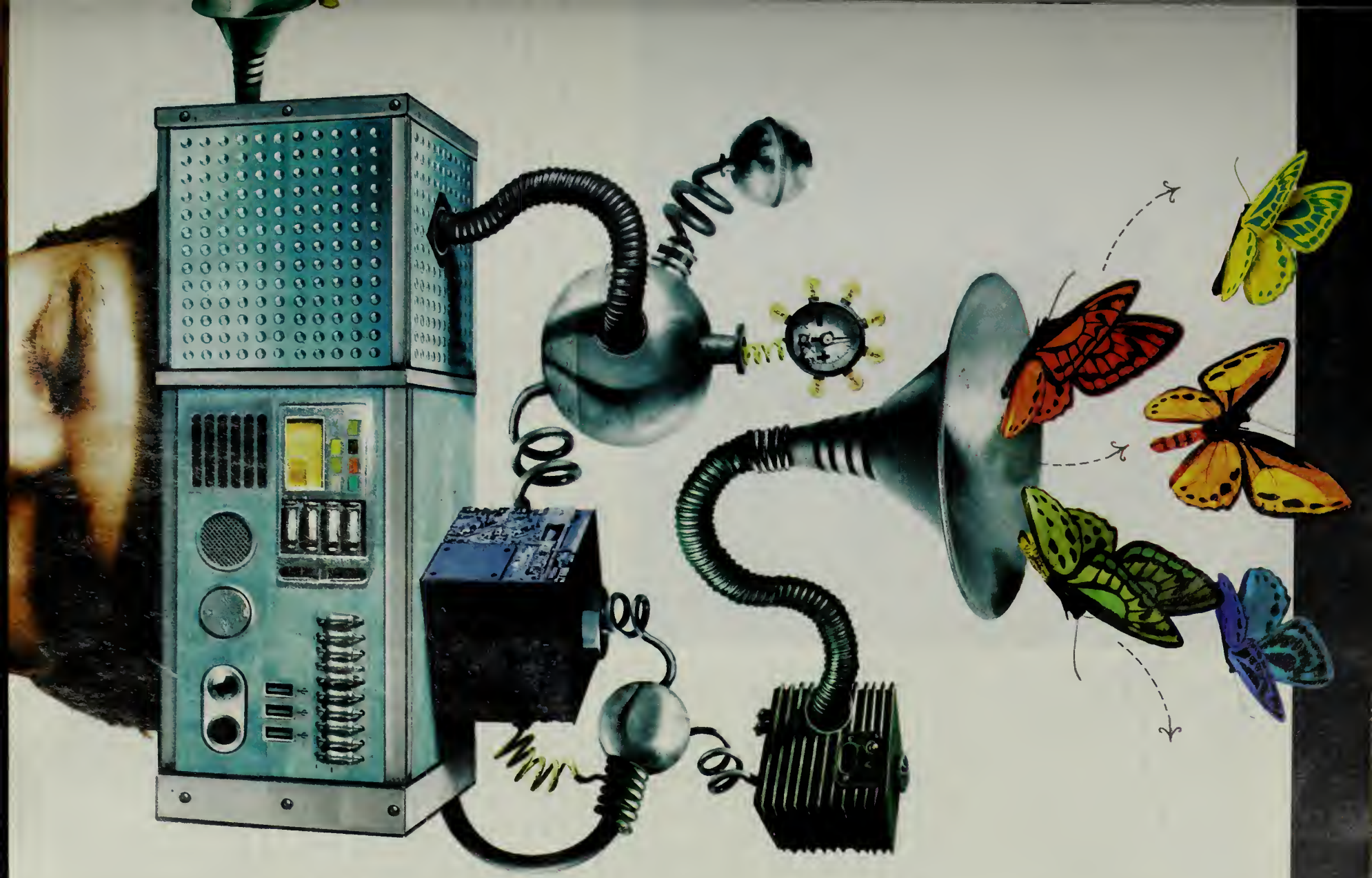

ILLUSTRATION BY RICHARD BORGE

the world and, not incidentally, make all of the participants rich.

As the experts spoke, Intellectual Ventures' patent lawyers, many of them with doctorates in science themselves, monitored the highly technical interchange, taking notes, recording the conversation from two microphones hanging from the ceiling, and snapping pictures of whiteboard drawings. The room was windowless, the furniture standard issue, and the participants casually dressed. They fueled themselves with caffeine, beef jerky, and nuts. Throughout the conversation's many twists and turns, an IV staffer at a computer terminal summoned relevant articles or patent documents and projected them on the wall for all to see. "This is really cool!" enthused IV CEO and co-founder Nathan P. Myhrvold, the moderator of the session, in reaction to one concept tossed out at the meeting. "This is really damn cool!"

Is this the future of invention in America? Myhrvold, 47, is betting that it is. Very few others, whether in business, government, or academia, are willing to spend as much money, and wait as long, to nurture fundamental innovation. As intellectual property becomes a bigger part of the economy, figuring out how to invest in it will become a more urgent issue. Though there will undoubtedly be competition, Myhrvold hopes to set the standard. His ambitious goal is to own the next generation of transformative technology in some of the world's fastest-growing industries. Over the past three years, Intellectual Ventures has held about 70 brainstorming sessions. The result: 500 patent applications in areas including optics, biotechnology, robotics, e-commerce, and mobile networking. "We think that if we specialize in invention, we can do it better than people who do it as a sideline," he says.

MYHRVOLD Microsoft's original chief technology officer says he'll leave the manufacturing to others

ON THE PROWL

MYHRVOLD'S BOLD WORDS MIGHT be easily dismissed if they came from somebody else. But you have to take him seriously. The brainy mathematical physicist, who made a fortune during 14 years as a top Microsoft Corp. scientist, exuberantly engages in conversation about almost everything, from cooking (he trained at a French culinary school) to cosmology (he studied curved space-time with Cambridge University's Stephen Hawking) to paleontology (he's a sponsor of dinosaur digs). Myhrvold is perhaps the only person in the world with both the scientific credibility to attract Intellectual Ventures' all-star roster of inventors and the business contacts to lure the company's blue-chip investors, which include Microsoft, Intel, Apple Computer, Sony, and Nokia.

With his pink cheeks, curly blond hair, and jovial manner, he can seem almost cherubic. But not everybody views Myhrvc as an angel—far from it. That's because Intellectual Ventures not just a think tank where big brains sit around dreaming ideas. It also has a second business, one that is generating co troversy: buying patents. In fact, that's a much larger part the operation. Maintaining secrecy through shell compani and nondisclosure agreements, often swooping in aggressiv ly to seal deals, it has scooped up thousands of patents and on the prowl for many more. That has many people in the te world worried.

What's so frightening about patents? Inscrutable doc ments with funny schematic drawings, patents reward inve tors with an exclusive right to their inventions. They seem all-American, evoking images of Thomas Edison and Eli Wh ney. But lots of small companies, disparagingly called trol have gone into business solely to own a handful of paten They then make money, sometimes lots of it, by going out a suing companies they think ha ripped off the inventions. T case that has thrown the m fear into big companies is N Inc.'s lawsuit against BlackBe maker Research in Motion Lt which RIM paid $612 million settle in March.

110
Number of people employed at Intellectual Ventures

With its vast hoard of paten IV could turn out to be t world's biggest patent troll. could have the power, at least theory, to sue a vast swath of C

yhrvold's Business Plan

ctual Ventures is in the invention business. It acquires in two ways: by developing its own patents and by buying g patents from companies, schools, and duals. Here's how it intends to make money:

N IV BUYS A PATENT

stors put their money into a d that acquires intellectual ty in core technology areas s chip manufacturing and nmunications.

ellectual Ventures' in-house ff scours the market for le patents, picking up prop- rom corporate bankruptcies, sities, and lone inventors.

V decides that a company is ringing its patents, it ts licensing fees. If the d infringer fights back, IV has ht to sue for royalties.

V sees an opportunity to create new product, it will license chnology or form a joint e. It has no plans to acture anything itself.

WHEN IV DEVELOPS ITS OWN TECHNOLOGY

1 A separate investment fund is dedicated to fostering innovation. It has a longer-term payout horizon than the patent acquisition fund.

2 The money funds brainstorming sessions attended by IV's team of 25 highly credentialed "senior inventors," as well as IV's in-house lawyers.

3 IV's staff takes the ideas from the brainstorming sessions and turns them into patents. Inventors get a share of any ultimate royalties.

4 The company then seeks to cash in on its investment through licensing deals or joint ventures.

rate America, becoming a force that smothers rather than rtures innovation. "There's just a lot of questions about all of ese patents they have and what they are going to do with em," says Christina Schneider, a spokesperson for Hewlett- ckard Co., echoing concerns heard widely in Silicon Valley.

Myhrvold, not surprisingly, dismisses these fears. He says 's opposed to patent litigation. In response to charges that he a predator, Myhrvold describes himself as an entrepreneur- financier, somebody who is devising new ways to fund in- vation. He likens himself to the first generations venture capitalists and private-equity investors, no were also widely vilified. Myhrvold believes at there is an emerging trend to treat intellectu- property, and patents in particular, as an asset at people and companies will invest in, the same ay they do in real estate or stocks. The result, he lieves, will be a boon for invention, just as ven- re capital and private equity have stimulated ormous growth and innovation in the American onomy. "I'm one of the first invention capital- s," he says.

Of course, being a trailblazer has its perils, one of hich is that the trail may go off a cliff. The business odel Myhrvold and his fellow IV executives have eamed up is ambitious and unproven. It is unclear it will be able to produce a consistent revenue eam. Six years after opening for business and near- four after first soliciting funds, IV still appears years vay from offering its investors any return.

Brought up in modest circumstances by a single mother in Santa Monica, Calif., Myhrvold describes himself as an almost accidental mogul. Taking a leave from studying cosmology at Cambridge University to help friends with a software project, he found himself in 1984 heading a startup known as Dynamical Systems. Two years later it was acquired by Microsoft, where he ended up as the company's first chief technology officer and a close adviser to Bill Gates. Some in the tech industry dismiss him as an intellectual dandy, a brilliant attention seeker who never managed to produce any important innovations at Microsoft. Yet the barbs have done little to tarnish his star. Now he travels by private jet and hobnobs with Warren Buffett, Michael Bloomberg, Steven Spielberg, and Herb Allen.

SPREADING RISK

MYHRVOLD'S TIME at Microsoft planted the seeds that would grow into his vision of IV, which he and Edward Jung, who had also been a top scientist at Microsoft, co-founded in 2000. One formative experience was his role in creating Microsoft Research, which now employs more than 700 researchers. A key insight he had in developing the operation, he says, is that predicting which inventions will be successful is enormously risky, and the only way to mitigate that risk is to invent on a very large scale. So just as a stock fund manager spreads his exposure over many positions, IV is aiming for a diversified portfolio of patents.

The invention sessions are part of that strategy. Myhrvold believes they enable IV to come up with breakthrough ideas because they combine the insights of an interdisciplinary group of experts in a way that rarely happens in industry, where expertise tends to be siloed. At the June 17 session, for instance, Lowell L. Wood Jr., a physicist who once designed nuclear weapons; Michael A. Smith, a chest surgeon from the University of Southern California; and Edward S. Boyden III, a biomechanical engineer, are among those at the table who watch as neurosurgeon Dennis J. Rivet gets up and walks over to the whiteboard.

It's midday, the air in the room has grown stuffy, and the coffee has long since run out, but the energy and attention level remain high. Rivet starts to describe a problem he faces with aneurysms. Taking a marker, he draws a picture of a blood vessel with an ominous balloon-shaped bulge.

"This is a common problem?" asks Myhrvold, who has no problem at all following a discussion about the technicalities of endovascular surgery. "It is," replies Rivet. "It's what I think about in my spare time." Myhrvold's eyes light up, and almost instantly the room is crackling with ideas for solutions. The IV patent lawyers type furiously, preparing notes they will later mine for patent ideas.

Using shell companies to mask its identity, Intellectual Ventures has purchased thousands of patents

The payoff from these concepts could take a long time to arrive. It takes at least three years to apply for and win a patent. And then comes the really hard part: finding somebody to commercialize it. Because Intellectual Ventures is only about ideas, Myhrvold has no interest in manufacturing and marketing new products. His plan is to offload all of that work to licensees. Intellectual Ventures needs to attract "patient capital," Myhrvold says. The company tells investors that there's "no guarantee of profit after five years."

As for the inventors themselves, they get a share

of the ultimate profits if they are listed on the patent—a matter on which Myhrvold is the ultimate decision maker. IV also pays for their time and expenses. But Rivet says that money is only a small part of the equation. "The appeal is twofold: the opportunity to interact with a diverse group of thinkers purely for the sake of invention, and the efficiency with which IV translates imagination into intellectual capital."

Although IV's own invention efforts are what Myhrvold enjoys talking about most, they are not the most important part of the business. The company, in fact, spends much more money buying ideas generated by others. Armed with its billion-dollar war chest, IV has stockpiled thousands of patents, according to Myhrvold, who will not disclose the precise number.

"TROLL REPELLENT"

WHEN MYHRVOLD AND JUNG first began raising money for IV in 2002, the sales pitch was crystal-clear: The company's patent portfolios would provide a way for big tech companies to defend themselves against intellectual property lawsuits. At the time, many people feared an explosion in patent litigation because of the bursting of the dot-com bubble, which had sent many startups into bankruptcy. That, in turn, had forced the defunct companies to put their patents—their last remaining assets, in some cases—on the market at bargain-basement prices. The threat that opportunistic trolls would buy the patents and then file lawsuits alleging infringement worried many executives in Silicon Valley.

30%

Employees of Intellectual Ventures who are patent lawyers

So Myhrvold and Jung began making the rounds of major technology companies to drum up investment in what they called the Patent Defense Fund, a name that pretty much translates into "troll repellent." Initially, each company, say several individuals familiar with the sales effort, was asked to pony up $50 million. The plan was that IV would then go out and buy patents that were knocking dangerously around the marketplace, and investors would get a license to the entire portfolio—effectively immunizing them from the danger of intellectual property litigation.

Legal developments, meanwhile, provided some useful marketing support for the concept. In February, 2003, a jury hit Sony Corp. with $25 million in damages for infringing a handful of patents that the plaintiff had purchased for $65,000. (Sony settled for an undisclosed amount and took out a license.) Sony signed on with IV, as eventually did Intel, joining a group that now includes Microsoft, Apple, Nokia, Google, and eBay. Some have paid much more, and some less, than $50 million. IV declines to confirm the identity of its investors, and the other companies declined to comment or did not return calls. IV requires investors to sign a nondisclosure agreement.

Myhrvold predicts intellectual property could become an asset class, no different from real estate or stocks

Although the ostensible purpose of the Patent Defense Fund was to protect its big investors, some executives saw an implicit threat when IV approached. It was "the greenmail pitch," says Jim Huston, a former patent and licensing executive at Intel, now at Blueprint Ventures, a South San Francisco VC outfit. "If you don't invest, you're our No. 1 target." In other words, the worry was that IV would use the patents it bought to file infringement suits against companies that turne it down. Myhrvold scoffs at this charge, noting that businesse that aren't infringing have nothing to worry about, and that I has yet to file a single lawsuit.

But it's clear that many of IV's investors are ambivalent abou Myhrvold's enterprise. Intel and Apple, for example, happen t be charter members of a group formed last month called Coal tion for Patent Fairness. Myhrvold calls the CPF "the infringer lobby," since it has already begun pushing in Congress fc changes that he believes weaken protection for patent holder such as providing more avenues to attack a patent's validit The CPF, in turn, was eager to provide information and spoke people for this article to advance its view that IV is nefarious.

Jason Schultz, a lawyer at the Electronic Frontier Foundatio in San Francisco, who spoke on behalf of the CPF, criticizes I for its secrecy about such things as the identity of its investor "Having injected themselves into this debate about patent trol and patent reform, they've sort of placed their credibility on th line," Schultz says. "So transparency is important."

Despite the fact that Myhrvold's backers include some of th biggest companies in technology, he spends a lot of time crit cizing them in public. The notion of tech heavyweights "stea

DRAWING BOARD Neurosurgeon Rivet during a brainstorming session at IV

." from inventors is a theme that Myhrvold returned to re-atedly in a series of interviews with *BusinessWeek*. At many computer and Internet companies, he says, there has long en a culture of intentionally infringing patents or turning a nd eye to potential infringement. "You have a set of people o are used to getting something for free, and they are some he wealthiest companies on earth," he says, his voice rising indignation as he steers his car through traffic on his way to e of his favorite Seattle restaurants. "I was there. I was in the etings. This is they way this business thinks about it." In hrvold's eyes, the fact that so many large companies are bla-t intellectual property rights infringers just means that re's more money to be squeezed from his patent portfolio.

For all the controversy surrounding IV, its fund-raising ef-ts have proceeded apace. It recently completed a second nd, part of it from institutional investors. IV stakeholders w include pension funds, VC firms, and wealthy individuals, hrvold says. Izhar Armony, a partner at VC firm Charles Riv-Ventures in Waltham, Mass., says: "I think that Nathan is on something really good and important." Charles River has in-sted in IV, he says, because "we share a common vision of nking of [intellectual property] as an emerging asset class." As its investor base has broadened and its strategic vision evolved, IV has recast the way it packages its product. All references to the Patent Defense Fund are gone. It now offers two types of investment opportunities. Investors can channel money into IV's own invention efforts, where the time frame for any return is quite long, or into the patent acquisition fund, which aims at quicker gains. While Myhrvold declined to comment on the size or structure of IV's funds, he hints that there are multiple vehicles to suit varying investor needs.

How IV finds what it wants to buy is "part of our secret sauce," says Peter Detkin, who coined the term "patent troll" in 2001, when he was an inside attorney at Intel Corp. He joined IV as a managing director in 2002. An in-house acquisition team scours the market for opportunities, but IV also relies on brokers and finders to bring it deals. Universities are another source of inventions, and IV has acquired patent rights from more than 50 of them.

STEALTH MOVES

INTELLECTUAL VENTURES can be very aggressive. After *BusinessWeek* ran an article in February describing the plans of a firm called Ocean Tomo to hold a public patent auction, IV got in touch with several of the companies identified in the article that said they planned to submit some of their patents for sale, says James E. Malackowski, Ocean Tomo's chief executive. It persuaded BellSouth Corp. to yank its lot from the Ocean Tomo auction and then bought the patents, which covered wireless services and voice messaging. (IV declined to comment on this.)

$1 billion
Approximate amount Myhrvold has raised from investors

Stealth is another of IV's hallmarks, as it is for many companies that don't want to tip off competitors to the type of technology they are buying—or drive up the price if they are seen as having deep pockets. The shell companies IV has used to acquire patents have whimsical names, often leaning toward the literary (Steinbeck Cannery, Dickens Coal, Kipling Sahibs) or the colorful (Sky Blue Interchange, Steel Gray Server, Midnight Blue Remote Access).

IV'S acquisitions range widely

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across many technologies. The aim, Myhrvold says, is to get a "critical mass" in 5 to 10 areas. While IV won't identify them, there is clearly a focus on core technologies such as chip manufacturing and design and telecom. IV's own invention efforts focus on such things as biotech and optics, which could produce some relatively near-term payoffs, and on highly esoteric fields where any bet is highly speculative, such as meta-materials, engineered composites with unusual electromagnetic properties. The materials have potential use in stealth technology for the military.

Ronald S. Laurie, at patent brokerage and consulting firm Inflexion Point Strategy in Palo Alto, Calif., calls IV "the buyer of last resort" for the sellers he represents. "You don't get the best price," Laurie says, "but you get a quick deal." IV got in touch with the inventors of a TV-related patent and offered them less than $50,000 for it. After the inventors retained broker IPotential, they got IV to go up to $150,000, but the inventors held out for more. The final sale price last year, to an Asian electronics company: $1 million. IV says the patent had problems because a lawyer had placed a lien on it, though that was resolved.

STILL BUILDING

THE $64,000 QUESTION (or $640 million, to approximate how much it cost BlackBerry maker Research in Motion to settle the patent infringement suit filed by NTP) is: How does IV plan to use its patent portfolio to make money for its investors? Is it going to devise cool new products? Or is IV going to launch a barrage of patent lawsuits against every big tech company that is not an investor? The company says it is at least a year from executing what it calls its "go-to-market" strategy. That's largely because it hasn't yet acquired a critical mass of patents. "There's strength in numbers," managing director Detkin says, because patents are more attractive when related technology can be bundled, giving users more freedom to operate.

Brent Frei, IV's executive vice-president, who's managing the go-to-market plans, says there are multiple ways it will extract value from its holdings that do not involve lawsuits. Intellectual Ventures could sell a patent to a company that planned to commercialize it. Or it could enter into a joint venture or a licensing arrangement. Those are all nice things. But the unavoidable fact is that not everybody will want to play ball with Myhrvold & Co. When Myhrvold asks some companies for licensing fees, they'll resist, and then Intellectual Ventures will have no choice but to go to court. Myhrvold adamantly rejects the idea that suing people will become a mainstay of his business operation. "Litigation is a huge failure," he say It's "a disastrous way of monetizing patents."

500
Number of patent applications filed by Intellectual Ventures

What Myhrvold hopes will happen instead is that what he cal the culture of infringement will come to an end and companie will voluntarily pay for rights to technology the use. He draws an analogy to a patron stiffing restaurant on a check by simply leaving witho paying the bill. Most people don't dine and das but it's not because they're afraid they would g caught and suffer consequences if they did. It's b cause most people simply think that paying f their meal is the right thing to do.

Twenty years ago, he notes, software makers- some of whom now flout patents—faced the sam predicament with trying to get the market to r spect copyrights. Even big corporations, he say would buy a single copy of a spreadsheet progra and copy it. That has largely changed, through e ucation, changes in the law, and some vigoro enforcement. Myhrvold is aware he may have do some enforcement of his own. A moment aft calling litigation "disastrous," he adds: "Som times disaster happens, and you have to do it."

Myhrvold has other ambitions that transcer IV's business. "I'd like to be successful enough th a model gets started," he says. That model entails network of firms that exist to finance invention. Ju as venture-capital firms took root in Silicon Vall 30 years ago, Myhrvold envisions an industry d voted to funding the earliest stage of the produc creation cycle. "Today invention is an area that pe ple view as too illiquid, too uncertain, and too risky, so that nobo wants to invest in it," he says. "The world has shown that if y provide capital and expertise to an area that is starved for capit and expertise," then "really good things will happen."

–With Moira Herbst in New Yo

Nathan P. Myhrvold

After a decade in the academic world, Myhrvold took a "leave" to help friends with a software project. Bitten by "entrepreneurial fever," he never went back.

BORN: Aug. 3, 1958, Seattle.

EDUCATION: Enrolled in college at age 14. Master's degrees from UCLA in geophysics and space physics.

NEXT STOP: Princeton University, where he obtained a master's in mathematical economics and a PhD in mathematical physics at age 23.

POST-GRAD WORK: Cambridge University, where he studied quantum field theory in curved space-time with Stephen Hawking.

FIRST REAL JOB: Software maker Dynamical Systems, which was bought by Microsoft in 1986. Ultimately became the software giant's chief technology officer before leaving in 2000.

COLLECTS: Antique typewriters, early computers, and fossils. A 16-foot-tall cast of a T. rex skeleton stands in his living room.

MEANING OF LAST NAME IN NORWEGIAN: Swamp forest.

Plenty of Patents Pending

Inside a Brainstorming Session: Michael Orey's first-hand report from the offices of Intellectual Ventures.

Scary Smart: Meet the scientists and engineers who are IV's senior inventors.

A Corporate Snapshot: Facts and figures about Intellectual Ventures.

Invention Central: For Executive Editor John Byrne's interview with Michael Orey on his peek inside IV, go to businessweek.com/search/podcasting.htm

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Playing on cell phones could bring in serious bucks for the industry

BY CLIFF EDWARDS

ASK ALYSON HEDSTROM whether she prefers Microsoft Corp.'s Xbox 360 or Sony Corp.'s PlayStation 3, and she just scratches her head. Mention that the shoot-'em-up game *Gears of War* delivers a rollicking PC gaming experience, and her eyes glaze over. Hedstrom perks up, though, when she talks about a game called *Diner Dash*, in which she takes on the role of former stockbroker Flo who quits her day job and works to transform a roadside diner into a five-star restaurant.

What may be more surprising is where she plays the game: The 21-year-old student and waitress downloaded it for $7 to her Verizon cell phone and fires it up three times a week during her droning 40-minute commute from her home in Boston to work. "I'm definitely not a gamer, but it's fun, easy to relate to, and has a realistic story."

HEDSTROM She likes to play games during her Boston commute

TOPPING RINGTONES

IT'S CUSTOMERS LIKE Hedstrom who give many of the top companies on this year's IT100 list evidence that big things are happening on the little screen. There's a mad dash among many of those companies to stake a claim in what's being called the Next Big Thing for mobile devices. Games industry researchers forecast that with nearly 2 billion phones capable of playing games by 2010, the industry could rake in as much as $18 billion, topping music ringtones and text messaging. That explains the rush of venture capital into so-called casual gaming companies. And it's why phonemakers such as Nokia and Motorola are teaming up with chipmakers Texas Instruments and Nvidia to create glitzy phones with big color screens and fast processors to make games more interesting to anyone with time on their hands and a phone in the pocket.

But this could also be the year when a the money moving into games gets put t the test. Big companies have become tru believers. It's still unclear, though, ho much demand there is for pricey game And telecom giants, meanwhile, charge pretty penny for entry to the systems.

OUTRACE, OUTGUN, OUTSMART

A FLURRY OF RECENT dealmaking offe a tantalizing hint of the future for mobil games. Says Larry Shapiro, executiv vice-president of Walt Disney Interne Group: "Messaging, chat, and voice com munication [in games] really hasn't bee done to any significant degree." The Wa Disney Co. unit plans to incorporate thos features in its games. Like console and P games, Nokia's snap Mobile aims to cre ate multiplayer game communitie where consumers can challenge anyor around the world to outrace, outgun, outsmart them on the small scree Game-industry giant Electronic Arts an others envision creating games that u fold like episodes of a television show.

Microsoft Chairman William H. Gat III wants in on the act, as well. Gat spoke in May for the first time at the gia industry video-gaming show, the Ele tronic Entertainment Expo, to pitch h vision of the software giant's Xbox Li game service on phones. He laid out strategy in which consumers could start racing game on the Xbox, continue it on PC, and use the phone to buy new c parts or pick new colors. "We're goi from 'Live' to 'Live Anywhere,'" Gat said. "It's about making gaming attra tive to people of every age."

For all the enthusiasm, conquerir the industry's challenges isn't as simp as blasting your way through to the ne level. Many mobile subscribers arou the world have played games like bi liards and golf that come with the handsets, but only a tiny fraction—abo 4%—actually find a game so compelli they purchase and download it. Despi hundred of millions already spent creating mobile games in the past ye

top-sellers continue to be old fa-ites such as *Tetris* and solitaire and ro hits such as *Pac-Man*.

Meanwhile, mobile-game develop-nt costs are rising as titles use more histicated 3D animation. And be-se there's virtually no standardiza-n of phone software, publishers have adapt individual games for each one on the market. Industry experts ve said this can add as much as ,000 for each "port" of a game to a w phone model.

ICES TOO HIGH?

HAT'S MORE DAUNTING, the mobile e of the market is essentially con-lled by wireless carriers, unlike PC d console games. They provide au-ntication and billing services and de-e which games to highlight and sup-rt. Some carriers demand half the take m each download on their network. ina, meanwhile, has more than 300 llion mobile-game customers, but v software providers make much ney because carriers spend almost ne of their marketing budget high-hting games.

Researcher M:Metrics Inc. warns that rket growth will slow unless things ange. "Consumers are not finding mes that appeal to them and are com-ining that prices are too high," says alyst Paul Goode, vice-president for oduct development at M:Metrics.

To gain scale and minimize chances at they'll fail, big players are swallowing small fry. Giants are also teaming up gain bargaining power with service op-ators. It's like a corporate game of *Pac-an*, but with real money—billions of llars—at stake.

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FUTURECOMPUTERS

The Next Cheap Thing

NComputing is reviving a '90s concept with a device that could give PC access to the masses

BY PETER BURROWS

STEPHEN A. DUKKER IS talking a mile a minute, his excited voice filling the small conference room. He's fiddling with a laptop PC, some cables, and a tiny gizmo that looks like something you might pick up in the accessories aisle at Radio Shack as he prepares to demonstrate the wares of tiny NComputing Co. "I have not been this excited about a company...ever," says Dukker, NComputing's chairman. "I'm afraid I'm going to have a stroke, I'm so excited!"

That's because Dukker is convinced NComputing has discovered one of techdom's holy grails: a computer cheap enough for the world's PC-less masses. Actually, not a computer. NComputing's gizmo—this one, the unsexily named L100 model—once attached to a mouse, keyboard, and monitor, can be used to tap into a PC somewhere else, across the room or across the continent, at a far lower cost than owning a PC yourself. Dukker's cost is less than $50 per user, vs. $250 for a cut-rate desktop PC. And if volumes rise as he hopes, that price could fall below $10. "Pretty soon, we'll have reached the point that the hardware is essentially free," says Dukker.

It's the return of the "thin client," one of Silicon Valley's most hyped concepts of the 1990s. Luminaries such as Oracle Corp. chief Lawrence J. Ellison and Sun Microsystems Inc.'s chairman Scott G. McNealy gushed back then over the idea that rather than own powerful PCs, Netizens could use these disk-less, processor-less "dumb" devices to access files and programs, stored on some remote server, via the Internet. It kind of made sense. After all, the disk drive and processor in your PC make up about 40% of the materials cost. And who uses all that processing power, anyway? For many of us, a PC is for sending e-mail and surfing the Web. Unless you're designing rocket ships or flying them in some graphics-rich video game, you barely test a PC's limits.

AHEAD OF ITS TIME

BUT REALITY STEPPED in. With PC prices falling ever lower, customers had a choice between a full-fledged PC and an unproven thin-client device that cost just about as much. The few models that sold were priced over $500 after expensive software licenses were taken into account. So they never really caught on. Today, all the attempts to reach the world's poor are focused on finding ways to make cheaper PCs. One of the most publicized efforts is the nonprofit "One Laptop per Child" program led by Massachusetts Institute of Technology's Nicholas Negroponte. The computer uses free Linux software rather than Microsoft's Windows and comes with a crank for people who don't have access to reliable power, or the means to pay for it.

But maybe, just maybe, the thin client was simply ahead of its time. Broadband connections, after all, are far more widespread today. And millions of people are comfortable with using Net-based software such as Google and MySpace. Now venture capitalists are starting to fund thin-client companies again, such as Teradici Corp. of Canada. Even PC giant Hewlett-Packard Co. is ramping up sales of $300-plus thin-client terminals to companies that want to cut the cost of managing software-

packed PCs. HP sees a day when consumers will pay a phone company or Net service provider only for the minutes of computing they use over a dumb terminal. "This is not just a 'wouldn't it be nice,'" says Philip McKinney, chief technology officer for HP's Personal Systems Group. "There are a lot of things that are starting to converge that begin to make this make sense."

Here's where Dukker would beg to differ. He says it's already happening. Despite having no real sales or marketing effort, NComputing has sold more than 100,000 units since 2004, and is on pace to sell nearly that many in the remainder of the year. Most are going to small companies and school districts in places like Brazil, Thailand, and Ghana. But interest is picking up with U.S. schools as well. Since stumbling upon NComputing's Web site, Tracy Smith, the director of technology for the Fremont School district in rural southeastern Idaho, has replaced 240 ancient PCs running Windows 98 with 80 NComputing devices. "I haven't told our Dell salespeople I'm doing this. But that's 240 computers that Dell didn't sell me."

Over 100,000 units have been sold since 2004, many to small businesses

O.K., so Dukker isn't turning the computer industry on its head just yet. But the role of change agent is one that is familiar to him. In 1998, Dukker's eMachines came roaring out of the gate to log $814 million in sales in its first year by selling nearly marginless machines that forced HP and IBM to get serious about sub-$1,000 PCs. Now that price band makes up more than 80% of all home PC sales. But there are legions of potential customers for whom even today's rock-bottom PC prices are too high. Former eMachines executive Young Song started NComputing (he's now CEO) after discovering that the company was unable to entice some people with $299 machines that had been returned and refurbished. To tap that market, Song says, "I knew we needed a new technology."

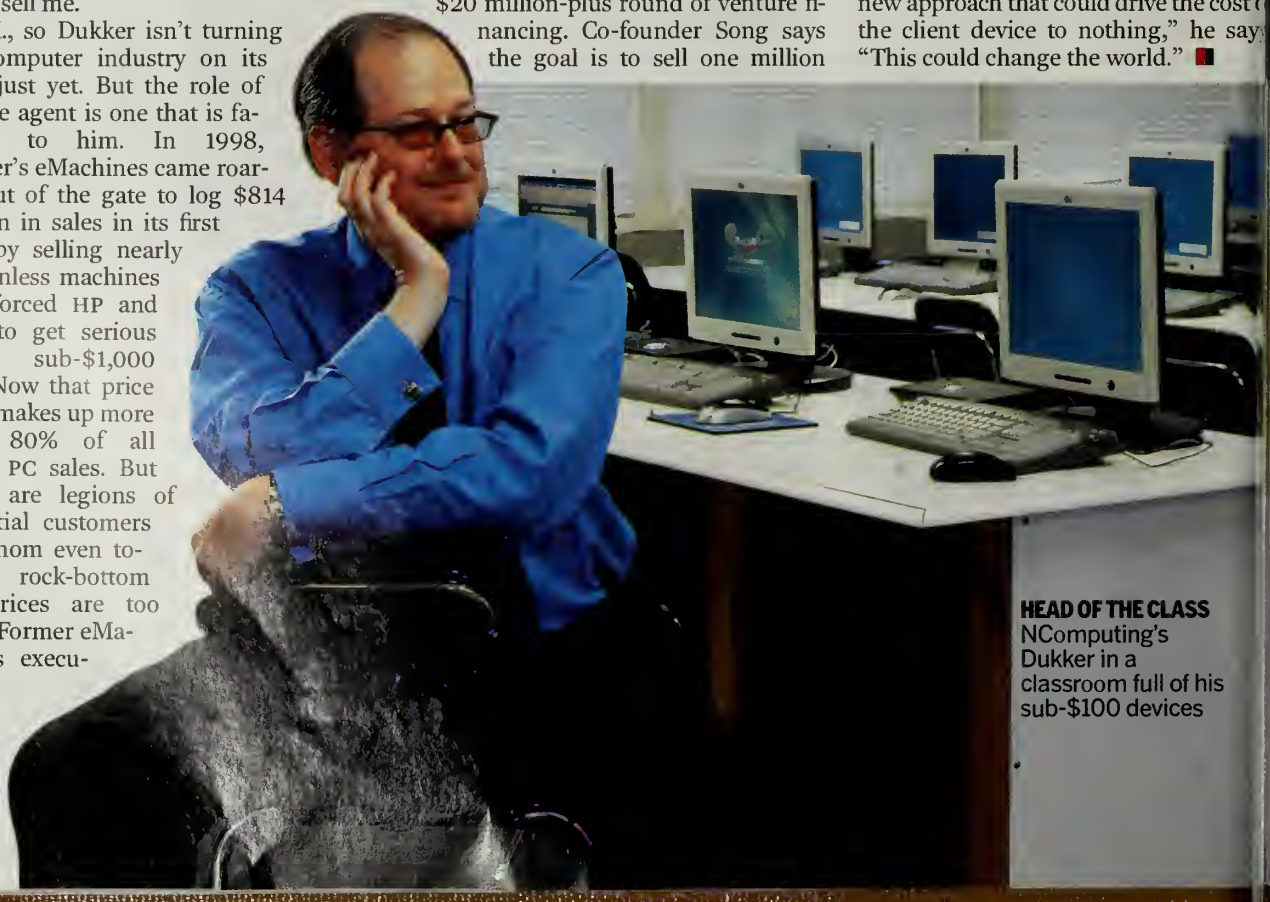
He needed a new job, as well. Song left eMachines soon after Dukker was pushed out in 2001, when the company nearly went broke. In 2003, Song connected with co-founder Klaus Maier, who had worked for more than a decade on software that would let you divvy up an operating system and distribute it among many users over the Internet.

By late 2004 they'd converted that software into a cheap chip packaged inside a plastic enclosure with the circuitry to control a mouse, keyboard, and monitor. Thus was born the non-PC. Add in energy savings (the devices consume about 5% as much power as a PC) and lower support costs (there's little inside that can break), and you start to see the logic. Dukker will really push his case once NComputing completes a $20 million-plus round of venture financing. Co-founder Song says the goal is to sell one million units by 2008, and not just as PC replacements. NComputing is talking with makers of TVs, cash registers, factory equipment—anything that could benefit from offering a PC-like experience.

Sounds big. But then so did the thin client. And there is one big potential legal obstacle. NComputing's technology in effect lets as many as 30 people use a single copy of Microsoft's Windows. NComputing doesn't resell Windows but leaves it for customers to interpret whether they're covered by their Windows license. Microsoft Corp. hasn't said exactly how it feels about that yet but you can imagine the possibilities. There's also the practical consideration of depending on uninterrupted Internet service in the Third World to use one of these devices. Says MIT's Negroponte in an e-mail: "Please remember that in many world, connections are spotty."

So maybe Dukker's campaign is a bit of a windmill tilt after all. "There's always been this idea that people have way too much computing power on their desks, but the fact is that people don't want to cede control back to a central authority," says Stephen Baker, a PC analyst for NPD Group. "History tells me this is likely to be a nichey product that doesn't get a lot of traction."

That's not dampening Dukker's spirits at all. "We are a signpost that there's a new approach that could drive the cost of the client device to nothing," he says. "This could change the world." ■



HEAD OF THE CLASS NComputing's Dukker in a classroom full of his sub-$100 devices

nifer Elias and Julie Tucker, Founders, SmartsCo

On a wintry night last year, SmartsCo, a publisher of party games, received a frantic call. A retailer needed stock overnight for a holiday event. So Jen and Julie packed their cars and hand-delivered it. "Likewise," says Jen, "when we sorely needed better cash flow, American Express cared enough to make sure we got it."

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SAMSUNG

FUTURESOFTWARE

More to Life Than the Office

It's being updated furiously, but Microsoft's once-irreplaceable program now has some viable rivals

BY STEVE HAMM

DON'T EXPECT VIJAY SONTY to get any Customer of the Year awards from Microsoft Corp. The chief information officer for Florida's Broward County school system negotiated to pay only $14 per copy this year to outfit 40,000 employees with the Microsoft Office productivity suite. At retail, the bundle of the Word, Excel, Outlook, and PowerPoint lists at $399. But for Sonty, even a $14 annual subscription is still too expensive. That's why over the next three years he plans on cutting his Office purchases to 5,000. In its place, he's buying IBM Workplace, which not only includes Office-like applications for employees but also delivers online learning to the district's 274,000 students. His price: $4 per person per year.

For the vast majority of PC users, there's only one way to produce digital words and numbers—with Microsoft's Office. The ubiquitous suite of software programs has a 95% market share and 400 million copies in use. But now, for the first time in years, Microsoft faces some real competition. With a new version of Office set for release late this year, customers may take the opportunity to consider software that's less expensive and easier to use. Like Sonty, they have several alternatives, including Corel's WordPerfect suite, IBM's Workplace, Apple's iWork, and the free OpenOffice program, increasingly popular with governments determined to bring Microsoft to heel. Plus, there's a host of free online offerings such as Google Spreadsheets and ajaxWrite, which appeal to youngsters not already hooked on Microsoft products.

GENERATION GAPS

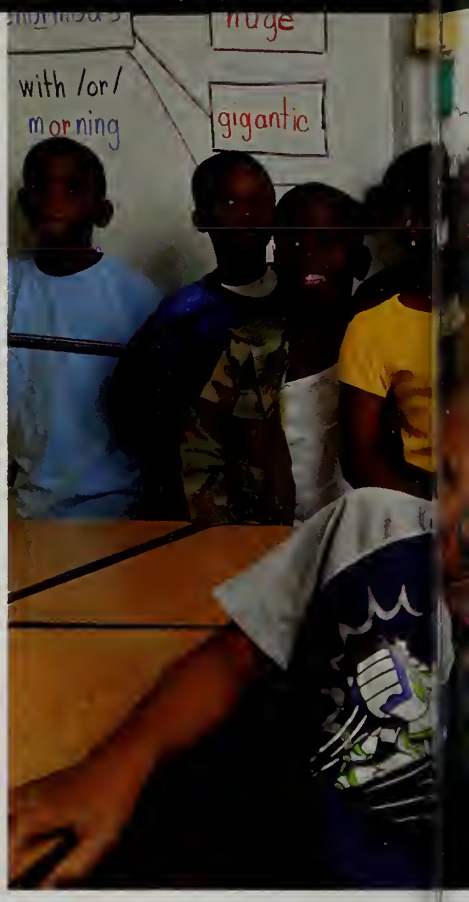
NOBODY EXPECTS Microsoft to collapse under this assault. Most users will figure it's easier to upgrade than to switch from Office, and the streets of techdom are littered with tattered companies that went up against Office and lost. Still, there's the potential for a flowering of choices for PC users. "People are dissatisfied with the status quo," says analyst Jason Maynard of Credit Suisse. "Who knows if you can break the monopoly, but if we see some innovation, there could be some big changes."

For years, Office's toughest competition has been, well, older versions of Office. Typically, when Microsoft releases a new version, up to 50% of its customers are still using the version from two generations earlier. The company has tried to encourage adoption by offering businesses multiyear contracts that include upgrade rights. But the results have been none too scintillating. According to an October, 2005, survey by market researcher Gartner Inc., Office 2003 represented just 45% of the installed base of customers that signed those contracts. And for companies that didn't sign up, it accounted for just 2%. This ho-hum attitude shows why sales of Office and related products are expected by Credit Suisse to grow a sluggish 5% this fiscal year. Such is Microsoft's frustration that last year it risked offending customers with a series of ads portraying those who don't upgrade as dinosaurs.

The new Office is due later this year. Most users will probably just upgrade

In an effort to gin up demand for the upcoming release, Microsoft has simplified navigation of the programs and improved the "help" function. If a PC user passes the cursor over an icon in Excel, for instance, it launches a little demonstration of how that feature can be used. "We're doing some amazing reinventions of our product to get people to see that there's a lot of new value we can deliver," says Chris Capossela, a Microsoft corporate vice-president.

For people who don't crave the latest bells and whistles, however, OpenOffice can be good enough. It's a clone of Office—meaning that it works similarly and that documents made with one set of programs can be viewed in the other. In four years the software has been downloaded more than 40 million times. While the main draw is for individuals, some large businesses and government agencies are trying it: Banco do Brasil, one of that country's largest banks, has it loaded on 35,000 PCs.



So far, OpenOffice hasn't put much of a ent in Microsoft's market share. That's artly because while its basic word rocessor documents and spreadsheets re compatible with Microsoft's, more omplex spreadsheets and some slide how presentations created in Office an't be viewed properly in OpenOffice.

But that could change. In May, the In- ernational Organization for Standardiza- ion approved a new technology standard, he Open Document Format, that's de- igned to assure that any word processor r spreadsheet application using it can ommunicate freely with any other. Gov- rnments, including Massachusetts' exec- tive branch, have decided to adopt the tandard. That means no one company—namely Microsoft—will hold the key to being able to look at all of their docu- ments into perpetuity. So far, the standard has been adopted by OpenOffice, Work- place, and some of the new online soft- ware packages. "We don't want to be forced to upgrade, and we want more competition," says Louis Gutierrez, Massachusetts' chief information officer.

Microsoft is fighting back. It has come out with its own new file format, which it pledges to license for free to all comers. Microsoft hopes to get approval from the standards group within 18 months. If it does, there will be two competing document format standards—which, some government officials say, would defeat the purpose of having a standard in the first place.

WOOING YOUTH

WHILE GOVERNMENTS and businesses face all sorts of hurdles if they want to switch from Office, consumers have little holding them back. To try out the latest online applications, all they need to do is point a Web browser at one of the many Web sites offering them. Take ajaxWrite, the first of a series of applications coming from startup Ajax13 Inc. The company's goal is to take the essential functions of Office to the online world—and add Web collaboration. It is a clear play for younger users. "They're the ones who are familiar with the online world. They don't need a box to hug," says Ajax13 Chief Executive Michael Robertson. Analysts expect Microsoft to create its own online applications if demand emerges.

THE TERMINATOR
Sonty is quickly curtailing Office use in Broward County schools

Over time, the software world is expected to move more to online applications. Gartner considers them a serious threat to Office just because they're so easy to use. "For consumers, I don't think you need to pay the premium to buy Microsoft Office anymore," says Credit Suisse's Maynard.

Further down the road, some techies believe productivity applications as we know them will become much less important. Instead of opening separate word processors and spreadsheets, people may tap into those functions within other applications—much as they now use a word processor within their e-mail programs. If that happens, Microsoft Office, rather than the company's customers, will look like the dinosaur.

Stacking Up the Office Alternatives

	USERS	COST	PLUSES	MINUSES
MICROSOFT OFFICE	400 million	$399 at retail	The de facto standard for PC productivity, with thousands of features	Expensive, hard to switch to alternatives, many bugs and viruses
OPENOFFICE	40 million	Free	The open-source package looks and works like Office and downloads easily	Some Office documents can't be read with the program
WORDPERFECT OFFICE	15 million	$299 at retail	A longtime competitor, it comes with many Dell and Lenovo PCs	Some Office documents can't be read
IBM WORKPLACE	1 million	$69	IBM's package of desktop and server software simplifies IT tasks	Its applications lack the bells and whistles of Office
AJAX13	10,000 per day	Free	This collection of Web applications enables people to work and share online	Current versions don't allow people to work on documents offline

FUTUREPHONES

Putting It All Together

Adding Wi-Fi could steady your connection, and video might even work

BY ROGER O. CROCKETT

EVERY YEAR CELL-PHONE makers, eager to get you and your pals to trade in that old clunker for a new handset, roll out a host of gee-whiz features. One year it's a phone that snaps pictures or plays music. The next it's a handset slim enough to slip into your pocket. Over the past few months video has become the latest hyped feature to light up the (very) small screen.

Yet through all its permutations—thick and thin, candy bar vs. flip phone—the ubiquitous handheld gadget remains maddeningly imperfect. Goofy interfaces. Dropped calls. Balky downloads. Isn't it time the likes of Nokia and Cingular Wireless made these darn things work better? Well, no promises here, but phonemakers say the next generation of mobiles rolling out this year and next will be simpler to use, drop fewer calls, and begin delivering a multimedia experience worth having. Ultimately, the industry hopes to make the cell phone what Rob N Shaddock, Motorola's chief technology officer for mobile devices, calls "a remote control for your life." That's a fancy way of saying your phone will do everything from record TV shows to update the calendar on your PC, all while you go about your business.

Sounds good, but let's not get ahead o ourselves. If there's one thing the phone guys need to get right, it's making mo biles better at their main job: placing and receiving calls. The industry has an answer, and it's called Wi-Fi—the same technology that allows you to wirelessly hook together your home PCs.

BACKUP BANDWIDTH

RIGHT NOW, a mobile connection depends on your proximity to a cell-phone tower. Go indoors, and chances are the phone craps out. No one knows this better than the 6 million Americans who have dumped their land lines to go completely cellular. "In hospitals, in an elevator, and at a school, unless I'm standing near a window, I don't get good reception at all," says Paul S. Aubrey, 34, a music instructor in Kansas City, Mo.

To get around the problem, Nokia and Motorola plan to roll out dual-mode

hones in the U.S. that use both the cell etwork and Wi-Fi hotspots in homes, of-es, java joints, wherever. The phone is pposed to seamlessly switch from one stem to the other, though how well it ill work remains to be seen. "The com-nation of cellular and Wi-Fi is a power-l one-two punch," says Frank Hanzlik, anaging director of the Wi-Fi Alliance, a ade group.

Theoretically, Wi-Fi will do more than ake calls reliable. Dual-mode phones ill also provide two ways of connecting the Internet—and the Wi-Fi hookup ill generate broadband peeds. T-Mobile USA al-eady offers two phones hat work with T-Mobile otspots.

As with most things cel-lar, the first models may ot work perfectly. Battery ower is an issue, for exam-le. Wi-Fi was built to ransfer data from comput-r to computer. But gab-ing all day on the phone onsumes a lot more juice. Manufacturers say the first hones will be able to han-le four to five hours of Wi-i talk time before dying. ventually they hope to chieve a full eight hours. "We're making huge rogress," Hanzlik says. "But at Day One ve're not at nirvana."

Battery life is a hurdle. On the first Wi-Fi phones, a charge will last only four or five hours

You can say the same thing about ex-sting cellular video services: Live TV it sn't—and people are not subscribing in he droves that Mobile ESPN, Verizon Vireless, and Amp'd Mobile had hoped or. Using Sprint Nextel Corp. or Cingular Vireless, the best you can expect is a hort CNN news update or an ESPN base-all highlight. And if a bunch of people in our neighborhood are trying to watch hose clips at the same time? The picture night fade out or not launch at all. "You an't just broadcast the cable company's ineup over cellular networks to hundreds f users today," says Paul Catalano, part-ner and wireless expert at consultant RelevantC Business Group.

To solve the problem, the industry is anking on new mobile systems such as UALCOMM's and a rival network sup-orted by Nokia, Intel, Motorola, and oth-rs. They promise to broadcast live TV ignals to huge swaths of the country just s cable or satellite companies do. These ystems will beam 20 to 30 channels at a ime. And they're designed to be robust nough to allow the viewing of action-jammed events, such as football and bas-ketball, that current technologies can't handle. By yearend, Verizon Wireless is expected to launch QUALCOMM's service to about half its markets. But few expect the offering to work as well as advertised or become a red-hot success overnight.

Besides, getting millions of people to actually watch their phones will require making handsets less, you know, phone-like. It's certainly no easy task to make a device the size of a candy bar as simple to operate as turning on the microwave. But manufacturers and carriers are thinking hard about eliminating keys and adding more voice recognition. Rather than requiring you to press sev-eral buttons and plow through menus to search for, say, World Cup updates, phones of the future will likely need only one button push or voice command. Say "search World Cup," and up will pop several links. Response time will be faster, too. "There shouldn't be the click-wait, click-wait," says John C. Burris, Sprint Nextel's vice-presi-dent for product manage-ment. "It'll be right there."

O.K., here's the part you've been waiting for: the cell phone as universal remote con-trol. Not far down the road, content—be it digital pictures, music, TV shows, or sim-ply the lowly contact list—will likely be stored in a server on the Internet rather than in a PC. The phone will allow you to access and control that information wherever you are. You will use it to send pictures to your PC or TV. You'll ask it to record a show while you're on the road. You'll use the phone to play digital tunes in your house and then transfer them to your car as you walk to the garage.

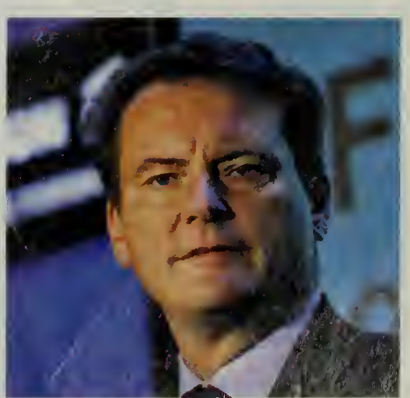
Finally, you will be able to customize your phone as never before. And we're not talking about adding a little bling as a fashion statement. Starting next year, car-riers such as Sprint and Verizon Wireless will go one crucial step further—allowing mobile-phone users to tailor their home screen to deliver whatever content they want. Turn on the phone, and you'll see scores for your favorite sports teams and up-to-date prices on your stocks. "The data can be pushed overnight to your phone or on the fly," says Sprint's Burris. Who knows? If Sprint and others can pull all this off, the venerable landline may be dead at last.

Telco Gear Titans

Chiefs of phone giants that made our IT 100 ranking

9 OLLI-PEKKA KALLASVUO
CEO, NOKIA
Nokia continues to dominate the mobile handset market

11 ED ZANDER
CEO, MOTOROLA
Motorola has soared on the strength of its sleek Razr



47 CARL-HENRIC SVANBERG
CEO, ERICSSON
Ericsson rebounded well after the telecom bust

FUTUREWEB

Lots of Loans, But No Banks

Finance co-ops have hit the Web, and they look like a good deal for borrowers and lenders

BY TIMOTHY J. MULLANEY

WHEN LYNA LAM'S family landed in San Jose, Calif., in 1983 after fleeing Vietnam, they soon learned what it means to rely on a community for money. Times were tough, with seven people in a studio apartment. "My parents were on welfare a long time," she says. But the Lams tapped into their local *hoi*, a cooperative of Vietnamese neighbors who pooled money to lend one another. Lam's father first used *hoi* to buy a used Oldsmobile. Then he borrowed from it to launch a landscaping business that took the family out of poverty.

Today the Net is taking the logic of Asian microlending co-ops global. One of the Web's most intriguing trends is the rise of peer-to-peer lending communities such as London-based Zopa Ltd. and San Francisco's Prosper Marketplace Inc. Fifteen-month-old Zopa (www.zopa.com) has attracted 75,000 members. But the most buzz surrounds Prosper, the four-month-old site (www.prosper.com) whose undisclosed number of members have made about 1,500 loans for over $7 million. Backed by eBay Inc. founder Pierre Omidyar and the venture capital firm that funded eBay, Prosper has spawned a raft of microbusinesses that recall the eBay economy. Prosper founder Chris Larsen is the former CEO of Web mortgage pioneer E-Loan Inc. His wife? Lyna Lam. "He was fascinated by how we work together and come through for each other—and that's how he started Prosper," Lam says.

"WHAT DO WE NEED A BANK FOR?"

AT FIRST BLUSH, the idea of making loans to complete strangers seems crazy. But it turns out that online communities can do a lot of what banks and payday loan companies do—and cheaper. In Prosper's market, loan rates are set by auction. Borrowers post an application, and prospective lenders bid on the interest rate, aided by basic analysis tools provided by Prosper such as simplified credit scores. Prosper rates borrowers from AA (top credit) to HI (high risk). Many lenders do extra re search; some contact prospects by phone

Analysts say peer-to-peer lending coul become a big deal. Americans make 6. million friends-and-family loans, for mor than $89 billion each year, says Ashees Advani, CEO of CircleLending, a Walthar (Mass.) startup that provides billing serv ices for friends-and-family loans. For rester Research Inc. lumps peer-to-pee lending with "social computing" phenom ena such as blogging, podcasting, an wikis that are shaking up industries. Th opportunity lies in consumers' mistrust o financial institutions: In Forrester studies most people believe their banks put thei own interests ahead of consumers', and majority don't think their financial institu tions have strong ethics. Their attitude says Forrester analyst Catherine Graeber "If we can get this done cheaper betwee ourselves, what do we need a bank for?"

That said, Prosper and Zopa probabl won't have an eBay-like upside. EBay cre ated the first national market for stuff peo ple used to move at garage sales and craf fairs. But capital markets are dominated b

companies that sell a smorgasbord of dit cards, mortgages, and other prodts to people with virtually any credit pro—and rates finely calibrated to borrow's' credit scores and other data. Fact is, no e knows if borrowers will reliably repay uns from relative strangers. CircleLend says 14% of person-to-person loans go paid in the non-Internet world. Zopa ys its default rates are a tiny 0.05%; osper hasn't broken out default rates. Then again, peer-to-peer lending isn't a k that can't be managed. The key is diversification. Loans are typically divided among lenders; a $5,000 loan might be funded by 100 people. Payments are sent directly to Prosper or Zopa, which distribute the money to lenders and report deadbeats to credit agencies or collection firms. Lenders can simply ignore high-risk borrowers; only 2% of Prosper applications from poor-credit customers have been funded, according to SavageNumber.com, an Atlanta Web site that tracks Prosper data. Formal arrangements seem to make people responsible about repayment even without a bank involved. Advani says delinquencies fall to 5% when friends-and-family loans use his firm's billing service.

The result: Loans are cheaper, while lenders can earn more than from other investments. Last month Doug Sophia borrowed $12,500 on Prosper to buy equipment for his new pizzeria in North Myrtle Beach, S.C., at 11.75%; his local finance company wanted 26%. Meanwhile, Frisco (Tex.) lender Dave Elliott, CEO of a small software company by day, says he expects a 13% return on 97 loans. "There aren't many investments that will get you more than 12% without much management," he says. Zopa CEO Richard Duvall says the average Zopa lender makes 7% to 10% after bad debt is written off, twice what top British savings accounts pay.

THE SHAME FACTOR

ONE DRAW IS the sense of community that online peer-to-peer lending shares with Asian co-ops, though there are some differences. At a May dinner for Prosper lenders in New York, a half-dozen agreed on a favorite example of their quirky clique: A mother of five who wanted breast implants to undo the effects of nursing. Members were impressed enough with her—and her AA credit—to bid the interest on her loan down to 7% from 14%.

Mostly, though, borrowers and lenders are drawn by better prices. Take Sophia, who plans to open Acme Pizza in late June. When a partner backed out in May, he needed money fast. Prosper rated his credit AA, its lowest-risk category. His three-year loan, at $413 a month, was not only cheaper than finance companies offered but also felt far safer to him than starting a business with revolving credit cards. "Once that teaser rate goes away, you're looking at the same rate as the finance company," he says.

For lenders, the trick is charging enough to cover defaults and still profit. If online communities are paid as reliably as others, says Prosper, lenders must add 2% or so to rates for defaults. Small fry are springing up to help: Part-timers from Germany to Atlanta have set up sites to crunch data about Prosper market conditions.

Most of all, Larsen relies on a strategy borrowed from *hoi*: shame. He says people repay real-world co-ops because they fear losing face among peers. So Prosper has 1,000 organized groups set up to let members lend to one another. "If you acquire customers through a Jimmy Stewart sense of community, you'll have a better business," he insists. And if his virtual savings and loan takes off, it will be a wonderful life indeed.

Power to the People

Peer-to-peer banking turns conventional banking on its head:

- The "lenders" are regular folks who put up their own money
- The returns are higher than those on other interest-bearing investments
- Borrowers get lower rates, less hassle
- But are they more likely to default on these unorthodox loans?

Internet Winners

Demand is running high for all things online.

13 **ERIC SCHMIDT**
CEO, GOOGLE
Despite search rivals, Google keeps gaining ground.

45 **REED HASTINGS**
CEO, NETFLIX
First, renting DVDs by mail. Next up, movie downloads.

(TOP) DANIEL ACKER/BLOOMBERG NEWS

MEXICO CITY One of Telcel's many phone-card sellers. Parent América Móvil ranks No. 1 in the IT 100

FUTUREMARKETS

A Race to Get People Talking

Latin America's cellular market is red-hot, and two players are jockeying for position

BY GERI SMITH

FOR DECADES, TRAFFIC lights in Mexico City have proven fertile territory for the legions of windshield cleaners, newsboys, and jugglers who swarm out into traffic looking to earn a few pesos from drivers. But in recent years, a new group has joined the crowds picking their way among the cars, VW Beetle taxis, and exhaust-belching minibuses: thousands of salespeople in yellow jumpsuits hawking prepaid cards for mobile phone carrier Telcel.

These young vendors are foot soldiers in the raging battle for the booming Latin American cellular market. The number of subscribers in the region jumped by a third to 234 million last year as Telcel's parent, América Móvil, faced off against Telefónica Móviles, the cellular arm of Spain's dominant fixed-line carrier, Telefónica. Today, some 45% of the region's residents have cell phones, and that's expected to surpass 50% by 2008. So far, América Móvil is in the lead, with 100 million wireless customers in 14 countries. But Telefónica Móviles isn't far behind, with 74 million subscribers in 13 Latin American countries and 20 million more in Spain.

STEPPED-UP INVESTMENT

SINCE MOST ADULTS in developed countries already own a mobile phone, the bulk of the growth in coming years will likely come from developing regions such as Latin America. Such expectations boosted América Móvil's shares by 79% in the year to May 31, helping it take the No. 1 spot on *BusinessWeek*'s InfoTech 100 list. Telefónica Móviles, though, isn't far behind. It's No. 6 on the IT 100 list, and its shares have jumped by 21%. And the action isn't only in cellular. Telefónica, which has fixed-line operations in six Latin American countries ranks No. 7 on the IT 100 while Telmex—Mexico's dominant operator, from which América Móvil was spun off in 2000—is No. 27.

Now, the two cellular rivals are stepping up their battle. América Móvil is using hefty profits from its home market in Mexico to fund investment in Brazil, where Telefónica Móviles reigns. And the Spanish company has tapped into its earnings in Spain and Brazil to build up its business in Mexico. "The rivalry between América Móvil and Telefónica has put a lot of dynamism into the marketplace," says Wally Swain, an analyst with the Yankee Group, a telecom consultancy.

The reason for the telecom explosion is simple: With prices for the region's commodities, such as iron ore, copper, steel, oil, and soybeans, at record levels, Latin America is growing faster than it has in years. And while the region typically suffers from high inflation during booms, this time around prices have held steady in most countries, increasing consumer buying power.

At the same time, the cost of networking gear has dropped by more than half in the past three years, making it less expensive to build wireless networks than to string wires to every village across the vast region. That has helped the two cellular leaders drive down rates. In Mexico, for instance, prices have fallen by more than half since 2002. And today, América Móvil serves every Mexican town with more than 5,000 inhabitants.

Political stability helps, too. As violence in Colombia has declined over the past year, the number of subscribers there has more than doubled, benefiting both companies. "A lot of areas used to be dominated by guerrillas, people didn't dare travel there, and there was no telecom infrastructure," says América Móvil Chief Financial Officer Carlos García Moreno. As América Móvil expanded operations, he says, "We were very surprised when we would set up a new radio base and find that it immediately became congested. There was a lot of pent-up demand."

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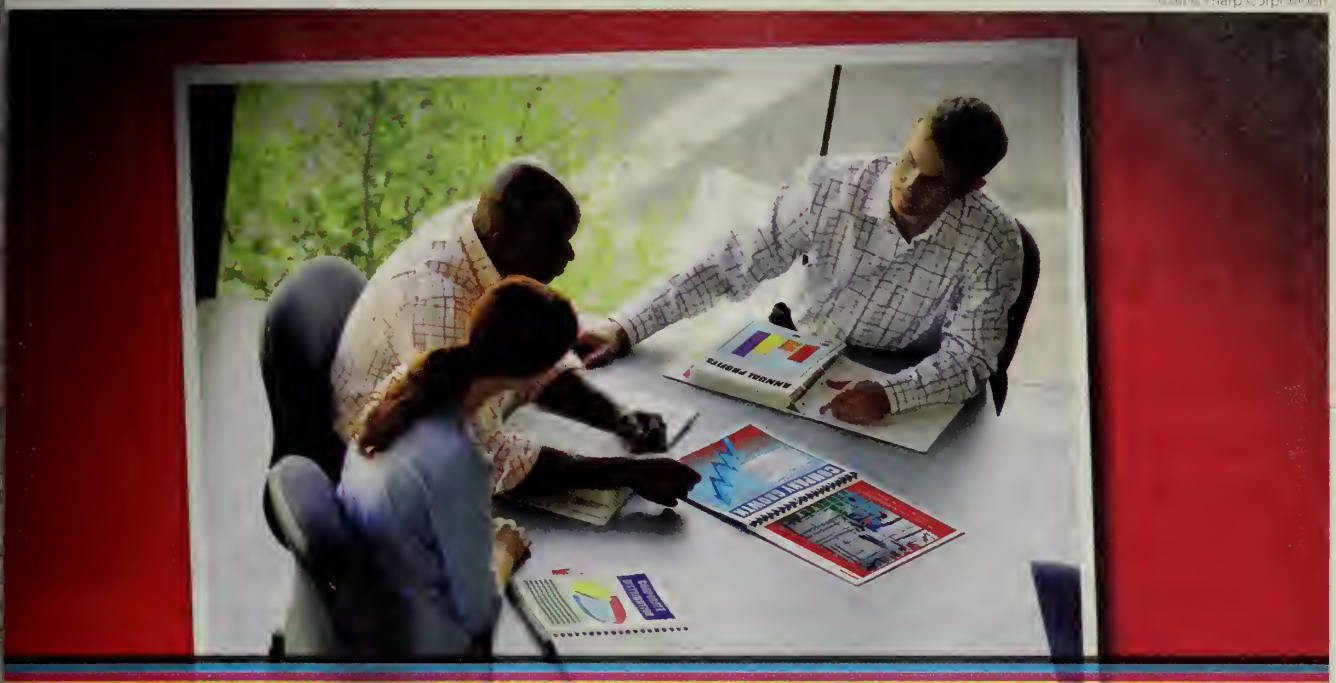
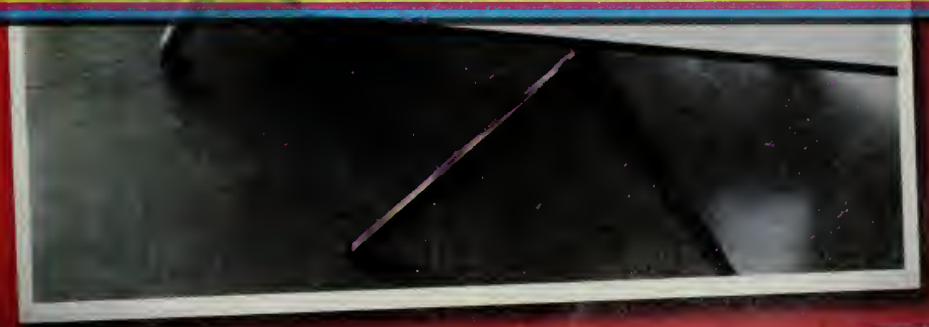
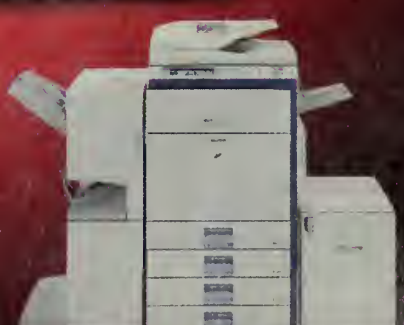


Any MFP can print colorful growth charts. How many can actually help you achieve them?





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THE RANKING

How the Mighty Have Fallen

Some of last year's strongest players didn't make the IT 100 list this time

BusinessWeek has done its yearly sifting of financial data to rank the top-performing tech companies—our Information Technology 100 (page 78).

SAMSUNG ELECTRONICS

ASIA'S MOST PROFITABLE IT company, Samsung Electronics, cranked out $8 billion in earnings in 2005. So why has it slipped off the IT 100, from last year's ranking at No. 5? Blame falling prices of memory chips and liquid-crystal displays, two of Samsung's major money spinners. As a result, revenues fell 2% last year, to $84.5 billion. Samsung's results were also hurt by the strength of the South Korean currency, the won. The world's third-largest mobile-phone maker after Nokia Corp. and Motorola Inc., Samsung sold a record 102.9 million handsets in 2005, but profits from that business fell 20% as it missed out on the boom in low-end handsets for emerging markets. Samsung is targeting an 11% rise in sales this year, but with the won already up 5.6% against the dollar this year, that goal may prove elusive.

IBM

SOME COMPANIES TUMBLE because they screw up. In the case of IBM, it exited an industry. Last year, No. 44 IBM sold its $11 billion PC business—which was rarely profitable—to Lenovo Group Ltd. That let it concentrate on selling tech services, server machines, and software. In the first quarter of this year, net income from ongoing businesses was up 21%, to $1.7 billion. But sales were flat, in part reflecting IBM's stagnant services business, which faces tough competition from Accenture Ltd. and from India's tech services upstarts. That's one reason Wall Street isn't excited; the stock is down 5% since Jan. 1, to about 78.

FRANCE TELECOM

FRANCE TÉLÉCOM, THE former state-owned telephone monopoly, has pushed into broadband and mobile services to offset stagnation in its traditional fixed-line phone business. Over the past few years it has reabsorbed mobile-phone and Internet businesses that it earlier had spun off, providing a boost to sales and margins, and helping propel it to No. 45 on the IT 100 in 2005. But these days it's struggling against competitors such as French company Iliad that have lured away customers with cheap bundled deals for phone, Internet, and television. Since Chief Executive Didier Lombard came aboard in February, 2005, France Télécom's share price has fallen by almost a third. Although profits last year nearly doubled, to $7.2 billion, revenues rose a meager 2.5%, to $62 billion.

INTEL

THE MOST BLUE-CHIP OF chip companies, Intel Corp. is suffering at the hands of rival Advanced Micro Devices Inc. Intel, No. 52 last year, watched sales erode and margins slip. In one high-profile blow, Dell Inc., which used to buy all its chips from Intel, in May said it expects to begin purchasing some server chips from AMD. After posting a 15% increase in 2005 income on a revenue gain of 13%, Intel in the April quarter posted a 5% decline in sales and a 38% drop in income. Intel is now cutting prices on some older chips to try to regain share. That could further weaken its sales despite the long-awaited introduction of its energy-sipping Core 2 Duo products.

This Time Last Year

What pushed these former tech stars off their perches?

5 YUN JONG YONG
SAMSUNG
A casualty of falling prices and a strong won

44 SAM PALMISANO
IBM
Stagnant sales in tech services

52 PAUL OTELLINI
INTEL
Dogged off the charts by AMD

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- > 24/7 customer support for worry-free service.
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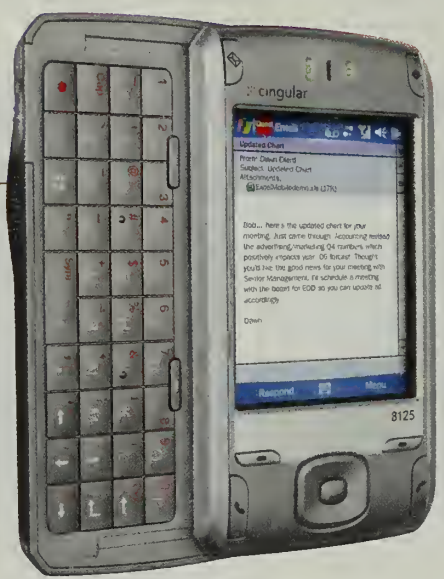

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THE INFORMATION TECHNOLOGY 100

To compile the Information Technology 100, *BusinessWeek* began with financial data from Standard & Poor's, a division of The McGraw-Hill Companies that has computerized information on 10,000 publicly traded corporations. We trimmed this universe to information-technology companies and then added non-U.S. tech companies recommended by our network of foreign bureaus. To qualify, companies had to have revenues of at least $500 million.

We divided this collection of about 500 companies into eight industry categories, such as software and semiconductors. Companies whose stock price has dropped more than 75%, whose sales shrank, or where other developments raised questions about future performance, were eliminated from contention. We also dropped some phone companies whose monopoly or near-monopoly power in their countries gives them an unfair advantage over competitors. The remaining group of companies was ranked on four criteria: return on equity, shareholder return and revenue growth (which were given equal weight), and total revenues (which was weighted). Then, the top 100 companies were reranked as a group.

REVENUES Latest available revenues for the most recent 12-month period for U.S. companies and the latest annual revenues for non-U.S. companies. Includes all sales and other operating revenues.

REVENUE GROWTH Percentage change in revenues compared with the previous corresponding year-ago period, in native currency.

RETURN ON EQUITY Net income available for shareholders divided by common equity, in native currency.

TOTAL RETURN The total return to shareholders, including dividends for the 12 months ended May 31, 2006.

PROFITS Latest available profits for the latest 12-month period for U.S. companies, the latest annual profits for non-U.S. companies. Net income from continuing operations before extraordinary items.

NOTE: Data compiled by Standard & Poor's from sources such as statistical services, registration statements, and company reports that S&P believes to be reliable but are not guaranteed by S&P or *BusinessWeek* as to correctness or completeness. This material is not an offer to buy or sell any security.

THE BIGGEST

	CURRENT SALES (MILLIONS)
HEWLETT-PACKARD	$88,885.0
VERIZON	79,676.0
DELL	56,738.0
TOSHIBA	56,555.3
AT&T	49,449.0
TELEFONICA	48,642.9
NOKIA	43,903.2
MICROSOFT	42,639.0
SPRINT NEXTEL	39,292.0
MOTOROLA	38,695.0

THE FASTEST GROWING

	REVENUE GROWTH
HIGH TECH COMPUTER	102%
GOOGLE	88
HON HAI PRECISION IND.	68
HUTCHISON TELECOM.	64
KOMAG	59
APPLE COMPUTER	56
TD AMERITRADE	53
COGNIZANT TECH.	53
VIMPELCOM	52
XYRATEX	51

THE MOST PROFITABLE

	RETURN ON EQUITY
AMAZON.COM	102.5%
DELL	100.8
BT GROUP	99.5
ACCENTURE	70.5
NEXTEL PARTNERS	63.1
COSMOTE MOBILE	52.2
HIGH TECH COMPUTER	51.3
AVAYA	50.4
TATA CONSULTANCY SVCS.	49.4
NOVATEK MICRO.	46.9

THE BEST RETURNS

	SHAREHOLDER RETURN THROUGH 5/31/06
HIGH TECH COMP.	313.8%
LG TELECOM	232.9
VTECH HOLDINGS	212.7
BRIGHTPOINT	206.9
AMKOR TECHNOLOGY	167.1
MILLICOM INT. CELLULAR	152.5
SANDISK	116.7
SOFTBANK	108.9
E*TRADE FINL.	96.5
NETFLIX	93.8

Data: Standard & Poor's Compustat, *BusinessWeek*

ALPHABETICAL INDEX OF COMPANIES

The number that follows each company name indicates its ranking in the table

Accenture 14
Acer 63
Advanced Micro Devices 58
Agilent Technologies 61
Alliance Data Systems 99
Amazon.com 23
Amdocs 98
América Móvil 1
Amkor Technology 76
Amphenol 81
Anixter Intl. 90
Apple Computer 4
Asustek Computer 32
AT&T 53
Avaya 41
Bharti Airtel 10
Brightpoint 29
Broadcom 87
BT Group 20
Canon 59
Cap Gemini 72
China Mobile 8
China Netcom Grp. 21
Cisco Systems 54
Cognizant Tech. Solutions 84
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Corning 85
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Dell 15
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Hoya 67
Hutchison Telecom. 33
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Inventec 17
Jabil Circuit 82
KDDI 62
Komag 40
L-3 Communications 55
LG TeleCom 64
Lite-On Technology 79
LM Ericsson 47
Logitech Intl. 91
MediaTek 35
Microsoft 37
Millicom Intl. Cellular 93
MiTAC Intl. 71
Mobile Telesystems 50
Motorola 11
National Semiconductor 100
Netflix 45
Nextel Partners 68
NIDEC 96
NII Hldgs. 30
Nikon 52
Nokia 9
Novatek Microelectronics 24
NVIDIA 73
Oracle 51
Palm 89
Qualcomm 69
Quanta Computer 31
Rogers Communications 65
SanDisk 46
SAP 39
Satyam Computer Svcs. 48
Seagate Technology 19
Sega Sammy Hldgs. 88
Siliconware Precision Inds. 92
SK Telecom 66
Softbank 5
Sprint Nextel 36
Tata Consultancy Svcs. 34
TD AMERITRADE 22
TDC 86
Telefónica 7
Telefónica Móviles 6
Telefonos de Mexico 27
Telekom. Indonesia 12
Telenor 25
Tellabs 77
Texas Instruments 74
Toshiba 26
TPV Technology 16
Turkcell 43
Verizon Communications 75
VimpelCom 49
VTech Hldgs. 78
Western Digital 38
Wipro 57
Wistron 18
Xyratex 60
Yahoo! 56
Yahoo! Japan 70

BusinessWeek online

For more information about the Information Technology 100 companies, go to www.businessweek.com/it100/

	COMPANY Country / Stock Symbol* / Industry	REVENUES $ Millions Rank	REVENUE GROWTH Percent Rank	RETURN ON EQUITY Percent Rank	SHRHLDR. RETURN Percent Rank	PROFITS $ Millions	COMMENTS
1	**AMERICA MOVIL** Mexico / TELE	16,108.0 21	31 38	37.4 11	82.7 13	2,798.0	Growth in Latin American consumer spending led to a greater expansion of wireless—and stellar results for América Móvil.
2	**HON HAI PRECISION IND.** Taiwan / COMP	28,440.0 14	68 3	22.5 47	51.5 30	1,272.2	A leading outsourcer for Nokia and Apple, Hon Hai announced June 20th that it will buy Taiwan's leading producer of digital still cameras.
3	**HIGH TECH COMPUTER** Taiwan / COMP	2,242.5 77	102 1	51.3 7	313.8 1	367.5	HTC's smart phones using Windows have an early lead, and its close ties with Microsoft have helped HTC stay far ahead of the pack.
4	**APPLE COMPUTER** U.S. / AAPL / COMP	17,306.0 20	56 6	19.9 60	50.3 32	1,725.0	Apple has been so successful in recent years that it's almost boring, as iPods have increasingly become standard equipment.
5	**SOFTBANK** Japan / NET	9,884.3 33	32 36	23.7 39	108.9 8	513.1	Softbank's multimedia mobile Internet strategy is coming together, aided by growth at its high speed broadband service.
6	**TELEFONICA MOVILES** Spain / TELE	21,204.3 17	40 23	33.4 19	23.1 67	2,464.0	With nearly 100 million subscribers, this wireless company is one of the biggest—and it's the main source of growth for parent Telefónica.
7	**TELEFONICA** Spain / TELE	48,642.9 6	25 49	34.9 13	1.6 88	5,708.7	Aggressive international expansion has made Spain's former phone monopoly one of the world's largest telecoms, and one of the most indebted.
8	**CHINA MOBILE** Hong Kong / TELE	30,281.9 13	26 45	19.6 62	45.8 38	6,672.0	It operates in a huge mainland market. But only 29% of the population has a cell—so China Mobile has lots of room to grow.
9	**NOKIA** Finland / COMM	43,903.2 7	16 69	29.7 26	25.2 64	4,643.2	The world's dominant mobile handset maker is morphing into a provider of handheld computers.
10	**BHARTI AIRTEL** India / COMM	2,519.8 69	46 13	24.6 37	63.3 21	487.9	India's largest cellular player, it created a trend when it farmed out its network management to Nokia and Ericsson.
11	**MOTOROLA** U.S. / MOT / COMM	38,695.0 10	21 61	27.7 32	22.3 70	4,593.0	Riding the success of its RAZR phone, Motorola's execution is now super sharp. Its new Q phone, a slim e-mail device, is creating buzz.
12	**TELEKOMUNIKASI INDONESIA** Indonesia / TELE	4,517.2 56	23 54	34.3 16	54.7 26	863.8	Earnings at the carrier jumped 21% in 2005. The wireless unit rakes in customers and profits through cheaper call rates and expanded coverage.
13	**GOOGLE** U.S. / GOOG / NET	7,135.8 40	88 2	16.5 67	34.1 54	1,688.5	Google's runaway lead in the Internet search market has stunned many analysts, as well as its competitors. Its market share is now up to 43%.
14	**ACCENTURE** U.S. / ACN / SVCS	17,840.8 19	11 86	70.5 4	22.3 71	819.0	Accenture is still adept at reeling in the big contracts. Its sales grew at more than double the rate of the tech services industry.
15	**DELL** U.S. / DELL / COMP	56,738.0 3	11 85	100.8 2	-36.4 100	3,400.0	Dell keeps getting bigger. It's seeing revenue gains in non-PC hardware, including servers and storage machines.
16	**TPV TECHNOLOGY** Hong Kong / COMP	5,054.0 50	35 30	17.5 63	56.3 24	149.6	The popularity of LCD TVs is driving demand for TPV Technology's thin-film transistor liquid-crystal displays.
17	**INVENTEC** Taiwan / COMP	6,198.7 45	45 15	10.7 88	59.3 22	102.1	With Toshiba outsourcing more of its notebook-computer production, Inventec has been a big winner.
18	**WISTRON** Taiwan / COMP	5,138.3 49	41 21	12.7 83	74.7 15	99.3	Wistron is one of the main beneficiaries of big customers spreading more of their notebook orders around. Another edge: It makes the Xbox 360.
19	**SEAGATE TECHNOLOGY** U.S. / STX / COMP	8,856.0 36	32 37	32.3 21	11.8 83	1,113.0	The Big Dawg in the disk-drive business increased its lock on this booming industry in 2005, then bought rival Maxtor.
20	**BT GROUP** Britain / TELE	36,510.7 11	6 97	99.5 3	15.5 79	2,894.4	BT is busy building up-and-coming technologies such as Internet telephony and wireless networking.

KEY TO INDUSTRIES: **COMM** =Communications equipment, **COMP** =Computers and peripherals, **DIST** =Distributors, **NET** =Internet companies, **SEMI** =Semiconductors, **SVCS** =Services, **SOFT** =Software, **TELE** =Telecommunications.

FOOTNOTES: *Only for companies traded on U.S. exchanges. †Total return is based on less than one year of data because IPO has occurred since May 31, 2006

THE INFO TECH 100

	COMPANY Country / Stock Symbol* / Industry	REVENUES $ Millions Rank	REVENUE GROWTH Percent Rank	RETURN ON EQUITY Percent Rank	SHRHLDR. RETURN Percent Rank	PROFITS $ Millions	COMMENTS
21	**CHINA NETCOM GROUP (HK)** Hong Kong / TELE	10,868.8 30	34 32	22.0 50	21.0 73	1,730.4	Smallest of China's four telecom companies, China Netcom is hardly puny. Sales grew 34%, powered by 115 million fixed-line subscribers.
22	**TD AMERITRADE HOLDING** U.S. / AMTD / NET	1,500.1 90	53 7	30.2 25	48.3 35	436.8	The real secret to the company's recent success has been CEO Joseph Moglia's aggressive acquisition strategy.
23	**AMAZON.COM** U.S. / AMZN / NET	8,867.0 35	22 59	102.5 1	-2.5 93	332.0	Amazon.com has proved it's a keeper. The reason: It has managed to keep free cash flow high even as it has upped technology spending.
24	**NOVATEK MICROELECTRONICS** Taiwan / SEMI	809.1 97	48 11	46.9 10	45.5 39	175.4	Last year was good for this designer of driver chips for LCD panels. But producers of panels report disappointing sales this year.
25	**TELENOR** Norway / TELE	11,348.6 26	14 75	16.5 66	52.9 29	1,259.5	A leader in Scandinavia, Telenor is turning to the burgeoning mobile markets of Eastern Europe and Asia for future growth.
26	**TOSHIBA** Japan / COMP	56,555.3 4	9 92	7.8 94	70.0 18	697.1	Toshiba built its reputation making TVs and laptops. Now its flash-memory chips for Apple iPods and cell phones are hot.
27	**TELEFONOS DE MEXICO** Mexico / TELE	14,409.7 23	17 66	27.8 31	14.5 80	2,492.0	Telmex focused on growing its subscriber base for Internet and corporate data transmission services.
28	**E*TRADE FINANCIAL** U.S. / ET / NET	2,847.9 66	36 27	13.5 77	96.5 9	487.0	Rebuffed in a bid to acquire TD Ameritrade, E*Trade turned its purchases of smaller online brokers Browncо and HarrisDirect into gold.
29	**BRIGHTPOINT** U.S. / CELL / SVCS	2,239.7 78	23 53	24.0 38	206.9 4	35.8	Brightpoint distributes wireless phones and accessories for Nokia and others. For virtual carriers, it can provide inventory management.
30	**NII HOLDINGS** U.S. / NIHD / TELE	1,903.9 83	40 25	21.8 53	82.8 12	194.7	NII Holdings is building a strong niche in the booming market for wireless phones in Latin America, where the untapped market is huge.
31	**QUANTA COMPUTER** Taiwan / COMP	14,947.8 22	45 14	15.7 72	-7.4 96	340.6	Transition time. Quanta teamed up with Sanyo Electric to produce LCD TVs. Meanwhile, it sold its display subsidiary to rival AU Optronics.
32	**ASUSTEK COMPUTER** Taiwan / COMP	11,161.7 28	43 16	16.6 65	-1.9 92	538.8	This producer of motherboards for PCs is looking to jazz up its image. Teamed with Lamborghini to create a new line of notebooks.
33	**HUTCHISON TELECOM. INTL.** Hong Kong / TELE	3,137.5 63	64 4	-2.6 100	72.1 17	-53.6	Having struggled with losses recently, it's counting on markets such as India, Thailand, and Vietnam to power future growth.
34	**TATA CONSULTANCY SERVICES** India / SVCS	2,796.1 67	23 55	49.4 9	34.7 53	623.0	For India's top tech player, the focus this year will be expanding deeper into Latin America and China.
35	**MEDIATEK** Taiwan / SEMI	1,647.0 87	30 39	34.6 15	50.0 33	570.0	A leader in semiconductors for DVD players, it has diversified into chips for handsets, which now account for about one third of sales.
36	**SPRINT NEXTEL** U.S. / S / TELE	39,292.0 9	42 17	3.3 98	-0.2 91	1,748.0	This telecom carrier's facelift has been dramatic. It's now completely focused on telecom's strongest cards: wireless and broadband.
37	**MICROSOFT** U.S. / MSFT / SOFT	42,639.0 8	10 90	32.0 22	-11.1 97	13,471.0	Microsoft has challenges—it trails rivals Sony, Apple, and Google in new markets where it seeks growth. But it still has Windows and Office.
38	**WESTERN DIGITAL** U.S. / WDC / COMP	4,196.2 58	22 58	30.9 24	35.6 52	317.2	As feature-packed cell phones and MP3 players become commonplace, Western Digital has changed gears to produce the drives needed for them.
39	**SAP** Germany / SOFT	10,930.4 29	13 76	25.9 36	23.7 66	1,921.5	SAP should continue to lead the enterprise software market as products for small- and medium-size businesses widen the customer base.
40	**KOMAG** U.S. / KOMG / COMP	754.2 98	59 5	28.9 27	44.0 43	133.3	The dominant provider of the thin-film disks inside disk drives, Komag has made the most of the booming demand for data storage capacity.

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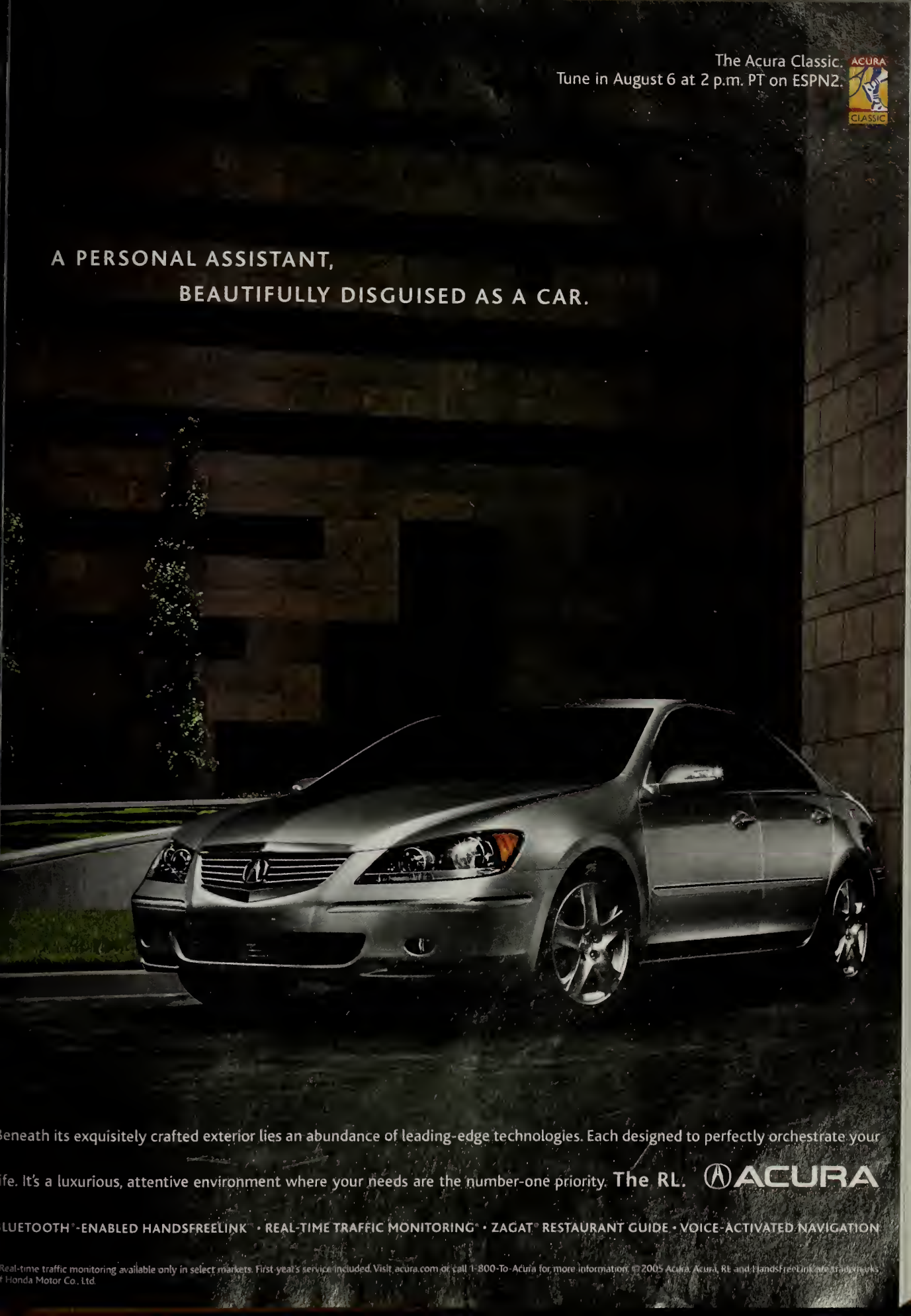
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THE INFO TECH 100

	COMPANY Country / Stock Symbol* / Industry	REVENUES $ Millions Rank	REVENUE GROWTH Percent Rank	RETURN ON EQUITY Percent Rank	SHRHLDR. RETURN Percent Rank	PROFITS $ Millions	COMMENTS
41	**AVAYA** U.S. / AV / COMM	5,019.0 51	12 79	50.4 8	29.1 59	963.0	In the emerging market that is combining voice and data networks, Avaya is the lead player providing the hardware and software.
42	**INFOSYS TECHNOLOGIES** India / SVCS	2,057.0 80	34 34	35.3 12	31.6 57	531.0	Infosys is expanding its employee base beyond India—it's hiring staff and even interns from top U.S. and European schools.
43	**TURKCELL ILETISIM HIZMETLERI** Turkey / TELE	4,268.5 57	33 35	33.5 18	5.3 86	910.9	Things have been going well for Turkcell, which saw its customer base grow to 29 million subscribers in the quarter ended Mar. 31.
44	**HEWLETT-PACKARD** U.S. / HPQ / COMP	88,885.0 1	7 95	9.8 90	45.5 40	3,615.0	Synergy at last? Under new CEO Mark Hurd, HP has cranked up profits in PCs for the first time in years.
45	**NETFLIX** U.S. / NFLX / NET	753.9 99	36 28	23.2 41	93.8 10	55.2	Renting DVDs by mail may be just the beginning for Netflix. Now it's investing in an online service to deliver movies over the Internet.
46	**SANDISK** U.S. / SNDK / COMP	2,478.4 70	35 31	11.8 85	116.7 7	347.0	The maker of those tiny cards for use in everything from digital cameras to cell phones has been branching out.
47	**LM ERICSSON** Sweden / COMM	21,038.1 18	15 72	23.2 42	0.6 90	3,369.4	Putting its handset business into the Sony-Ericsson joint venture let Ericsson focus on what it does best—selling to network operators.
48	**SATYAM COMPUTER SERVICES** India / SVCS	1,035.4 93	36 29	26.4 35	54.0 28	246.7	After being in the shadows of the big three in India, Satyam is focusing on the fast-growing banking, financial services, and insurance sectors.
49	**VIMPELCOM** Russia / TELE	3,211.1 62	52 9	22.4 48	12.1 82	615.1	Russia's No. 2 mobile operator is focusing on higher-value services as its home market reaches saturation.
50	**MOBILE TELESYSTEMS** Russia / MBT / TELE	5,011.0 52	29 41	34.2 17	-14.5 98	1,126.4	It's looking to less developed regions like Turkmenistan, where only 1% of the population currently owns mobile phones.
51	**ORACLE** U.S. / ORCL / SOFT	13,407.0 25	22 57	20.6 57	11.1 84	3,103.0	Oracle spent somewhere between $12 billion and $18 billion acquiring other companies in 2005, including PeopleSoft and Siebel Systems.
52	**NIKON** Japan / SEMI	6,516.7 43	14 73	11.9 84	79.5 14	258.0	A household name in digital cameras, Nikon's biggest hope for growth is in steppers—machines that print circuitry on silicon wafers.
53	**AT&T** U.S. / T / TELE	49,449.0 5	21 62	9.7 91	17.4 76	5,346.0	It ain't Ma Bell. SBC acquired the nation's biggest long-distance provider for its expertise in selling service to large companies.
54	**CISCO SYSTEMS** U.S. / CSCO / COMM	27,081.0 16	12 80	22.7 45	1.4 89	5,576.0	Life at the top can be tough. Cisco dominates the corporate networking world, but investors want more than 2005's 12% revenue growth.
55	**L-3 COMMUNICATIONS HLDS.** U.S. / LLL / COMM	10,386.0 31	42 19	11.6 86	3.9 87	545.0	After 11 acquistions in 2005, the sudden death of CEO Frank Lanza has Wall Street speculating whether the company may soon be takeover bait.
56	**YAHOO!** U.S. / YHOO / NET	5,651.0 47	42 18	21.9 51	-15.1 99	1,851.5	Yahoo has coupled its search share with its wide array of other Internet businesses and translated that into impressive growth.
57	**WIPRO** India / SVCS	2,290.7 75	30 40	31.4 23	26.4 63	448.6	The focus for Wipro is now on more profitable and high-growth services such as infrastructure management.
58	**ADVANCED MICRO DEVICES** U.S. / AMD / SEMI	5,953.1 46	19 64	7.8 95	88.4 11	367.4	When AMD introduced its powerful but energy-sipping Opteron and Athlon chips, it caught rival Intel napping. Market share continues to grow.
59	**CANON** Japan / COMP	33,470.4 12	8 93	14.7 74	33.2 55	3,424.4	Cost-cutting will help keep Canon's margins intact, but delays in the introduction of its flat-panel TVs have tarnished the company.
60	**XYRATEX** UK / XRTX / COMP	727.6 100	51 10	22.6 46	48.7 34	38.9	Xyratex is a leader in the arcane corner of techdom: making test gear for disk-drive manufacturers.

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61	**AGILENT TECHNOLOGIES** U.S. / A / COMP	5,416.0 48	5 99	28.2 29	45.3 41	1,147.0	Once part of HP, Agilent manufactures testing equipment, including scientific and electronic measurement products.
62	**KDDI** Japan / COMM	27,288.6 15	5 98	14.7 75	42.6 47	1,699.0	Few carriers make cooler cell phones than KDDI. That's one reason why it's defying gravity in Japan's ultracompetitive cell-phone market.
63	**ACER** Taiwan / COMP	9,921.8 32	41 20	12.9 82	–2.6 94	264.4	Acer is hot on the heels of rival PC maker Lenovo, so it's pushing more aggressively into Lenovo's key markets in China and the U.S.
64	**LG TELECOM** Korea / TELE	3,702.0 60	9 91	19.9 61	232.9 2	261.7	Though LG Telecom is the only Korean mobile carrier not yet upgraded to 3G, it still proved the best performer last year.
65	**ROGERS COMMUNICATIONS** Canada / RG / TELE	6,796.5 42	34 33	0.5 99	38.0 50	13.9	Take a Canadian cable network, stir in magazines, radio and TV stations, add wireless phone and the Toronto Blue Jays, and you get Rogers.
66	**SK TELECOM** Korea / TELE	11,310.0 27	1 100	22.8 44	27.1 62	1,975.7	With virtually every Korean citizen aged 15 and over already owning a cell phone, SK Telecom is venturing into new business to keep growing.
67	**HOYA** Japan / SEMI	3,069.0 64	12 81	27.1 33	46.1 37	674.2	Hoya is now the world's largest manufacturer of specialty glass plates used to make chips and liquid-crystal displays.
68	**NEXTEL PARTNERS** U.S. / NXTP / TELE	1,896.7 84	29 42	63.1 5	19.6 74	614.8	Soon to be incorporated into Sprint Nextel, Nextel Partners closed out the first quarter of 2006 with an additional 102,900 subscribers.
69	**QUALCOMM** U.S. / QCOM / COMM	6,493.0 44	25 50	17.2 64	22.4 69	2,311.0	Its CDMA-based chips power the handsets for an estimated 16% of the world's 2.3 billion wireless-phone subscribers.
70	**YAHOO! JAPAN** Japan / NET	1,548.6 88	47 12	33.1 20	8.2 85	419.8	A 67% increase in online advertising revenues helped solidify Yahoo! Japan's position as Japan's leading portal, with 63% share.
71	**MITAC INTERNATIONAL** Taiwan / COMP	2,600.2 68	41 22	21.6 54	22.1 72	154.1	MiTAC has expanded its server business to include Dell and IBM as customers. It's also a leading seller of PDAs.
72	**CAP GEMINI** France / SVCS	8,929.3 34	12 83	4.7 97	67.2 20	181.1	Cap Gemini now is practicing what it preaches after a restructuring that included offshoring some jobs to India and Eastern Europe.
73	**NVIDIA** U.S. / NVDA / SEMI	2,473.6 71	17 68	20.4 58	69.6 19	328.8	Graphics chipmaker Nvidia introduced technology to show off hot games like *Doom 3* in all their eye-popping glory.
74	**TEXAS INSTRUMENTS** U.S. / TXN / SEMI	13,754.0 24	11 84	21.9 52	13.4 81	2,456.0	TI saw explosive growth for its cellular chips, and its digital light processing chips are a favorite in rear-projection HDTVs.
75	**VERIZON COMMUNICATIONS** U.S. / VZ / TELE	79,676.0 2	10 88	16.3 68	–7.3 95	7,314.0	Pushing more aggressively into wireless, but it could cost $40 billion to pry away Vodafone's 45% share of Verizon Wireless.
76	**AMKOR TECHNOLOGY** U.S. / AMKR / SEMI	2,327.6 72	26 47	6.5 96	167.1 5	16.9	Amkor, a longtime player in global semiconductors, pioneered the business of outsourcing semiconductor assembly and testing.
77	**TELLABS** U.S. / TLAB / COMM	1,962.5 82	40 24	8.0 93	73.8 16	227.5	Tellabs stays on the cutting edge by pouring some 17.6% of sales into research and development—among the highest in the industry.
78	**VTECH HOLDINGS** Hong Kong / COMM	1,022.0 94	12 82	28.0 30	212.7 3	56.9	This producer of fixed-line phones and electronic games has successfully managed the task of connecting with American consumers.
79	**LITE-ON TECHNOLOGY** Taiwan / COMP	7,096.4 41	6 96	14.6 76	57.9 23	272.4	Lite-On is betting on Sony's Blu-ray high-definition video standard and plans to launch its first Blu-ray drive this summer.
80	**COSMOTE MOBILE TELECOM.** Greece / TELE	2,308.2 73	13 77	52.2 6	25.1 65	436.5	Greece's biggest mobile-phone company continues a push into Eastern Europe after last year's acquisitions.

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81	**AMPHENOL** U.S. / APH / SEMI	1,967.7 81	24 51	28.6 28	31.4 58	217.2	This maker of cables and connectors wires up everything from cable-TV signals to guidance directions inside a missile.
82	**JABIL CIRCUIT** U.S. / JBL / COMP	8,694.4 37	28 43	11.4 87	19.4 75	275.8	The contract manufacturer makes everything from semiconductor test devices to blood glucose monitors for diabetics.
83	**HEARTLAND PAYMENT SYSTEMS †** U.S. / HPY / SVCS	901.5 96	38 26	21.1 55	47.7 36	20.8	Heartland expects to process $40 billion in transactions this year. It also offers payroll services for its customers.
84	**COGNIZANT TECH. SOLUTIONS** U.S. / CTSH / SVCS	989.6 95	53 8	22.9 43	22.9 68	181.5	It provides custom programming for some of the world's largest companies with a workforce that is primarily located in India.
85	**CORNING** U.S. / GLW / COMM	4,791.0 54	18 65	9.8 89	54.7 27	592.0	Corning has come roaring back, thanks to surging demand for its ultrathin LCD glass used in laptops, flat-panel monitors, and LCD TVs.
86	**TDC** Denmark / TELE	8,021.9 39	10 89	8.1 92	54.8 25	606.3	Denmark's leading telecom player, TDC is turning to Eastern Europe and the Middle East to boost subscriber numbers.
87	**BROADCOM** U.S. / BRCM / SEMI	3,021.1 65	27 44	13.0 81	42.7 46	477.4	Broadcom isn't picking winners in the fight over adopting the Blu-ray or HD DVD video format: It makes chips for DVD players that will show either.
88	**SEGA SAMMY HOLDINGS** Japan / COMP	4,932.4 53	7 94	20.9 56	44.5 42	590.4	The Sega Sammy alliance has been a godsend for Sega after its Dreamcast game machine failed to catch on.
89	**PALM** U.S. / PALM / COMP	1,511.2 89	26 46	34.9 14	16.0 78	326.7	The handheld maker continues to prove the PDA market isn't dead: The Treo has become a darling of the business set.
90	**ANIXTER INTERNATIONAL** U.S. / AXE / DIST	4,041.4 59	19 63	13.4 80	42.8 44	100.9	There are lots of pieces that go into PC networks. That's a good thing for Anixter, which stocks over 325,000 wires, cables, and small parts.
91	**LOGITECH INTERNATIONAL** Switzerland / COMP	1,796.7 85	21 60	26.4 34	33.0 56	181.1	Logitech has climbed aboard the tech bandwagon, offering new peripherals piggybacking off the latest electronic devices.
92	**SILICONWARE PRECISION INDUS.** Taiwan / SEMI	1,356.5 91	23 52	20.2 59	50.8 31	257.1	Siliconware announced plans to boost capital spending by 50%, and now it has its eyes on a semiconductor packaging plant on the mainland.
93	**MILLICOM INTL. CELLULAR** Luxembourg / MICC / TELE	1,137.6 92	17 67	16.1 70	152.5 6	54.6	Capitalizing on a fast-growing customer base in the developing world, Millicom has seen its subscriber numbers soar over the past year.
94	**COMPAL ELECTRONICS** Taiwan / COMP	8,280.3 38	16 70	13.4 79	17.1 77	262.6	The problem for Compal: Dell giveth and Dell taketh away. To reduce its reliance on the PC giant, Compal's expanding into display screens.
95	**HARRIS** U.S. / HRS / COMM	3,304.3 61	14 74	13.4 78	42.7 45	214.0	If your communications systems need to be tough, stealthy, or secure, then communications equipment specialist Harris is a go-to firm.
96	**NIDEC** Japan / COMP	4,786.3 55	10 87	15.5 73	42.4 48	365.1	The digital era has been good to Nidec. The Kyoto-based company is a leader in tiny precision motors found in PCs, printers. and iPods.
97	**INTUIT** U.S. / INTU / SOFT	2,301.2 74	15 71	22.3 49	27.8 61	373.7	Thanks to a banner TurboTax year, revenues grew a solid 15% instead of the single-digit growth initially predicted by CEO Bennett.
98	**AMDOCS** Britain / DOX / SOFT	2,268.8 76	22 56	15.9 71	37.5 51	302.0	Amdocs excels at helping consolidating telecom companies sort out systems and boost customer service.
99	**ALLIANCE DATA SYSTEMS** U.S. / ADS / SVCS	1,653.8 86	25 48	16.3 69	40.7 49	158.0	ADS has become the back office to big business by processing millions of purchases—and markets the data from many of those transactions.
100	**NATIONAL SEMICONDUCTOR** U.S. / NSM / SEMI	2,158.1 79	13 78	23.3 40	28.1 60	449.2	Its analog-circuit business may be considered boring, but with firms like Apple snapping up its chips for iPods, boring equals big business.

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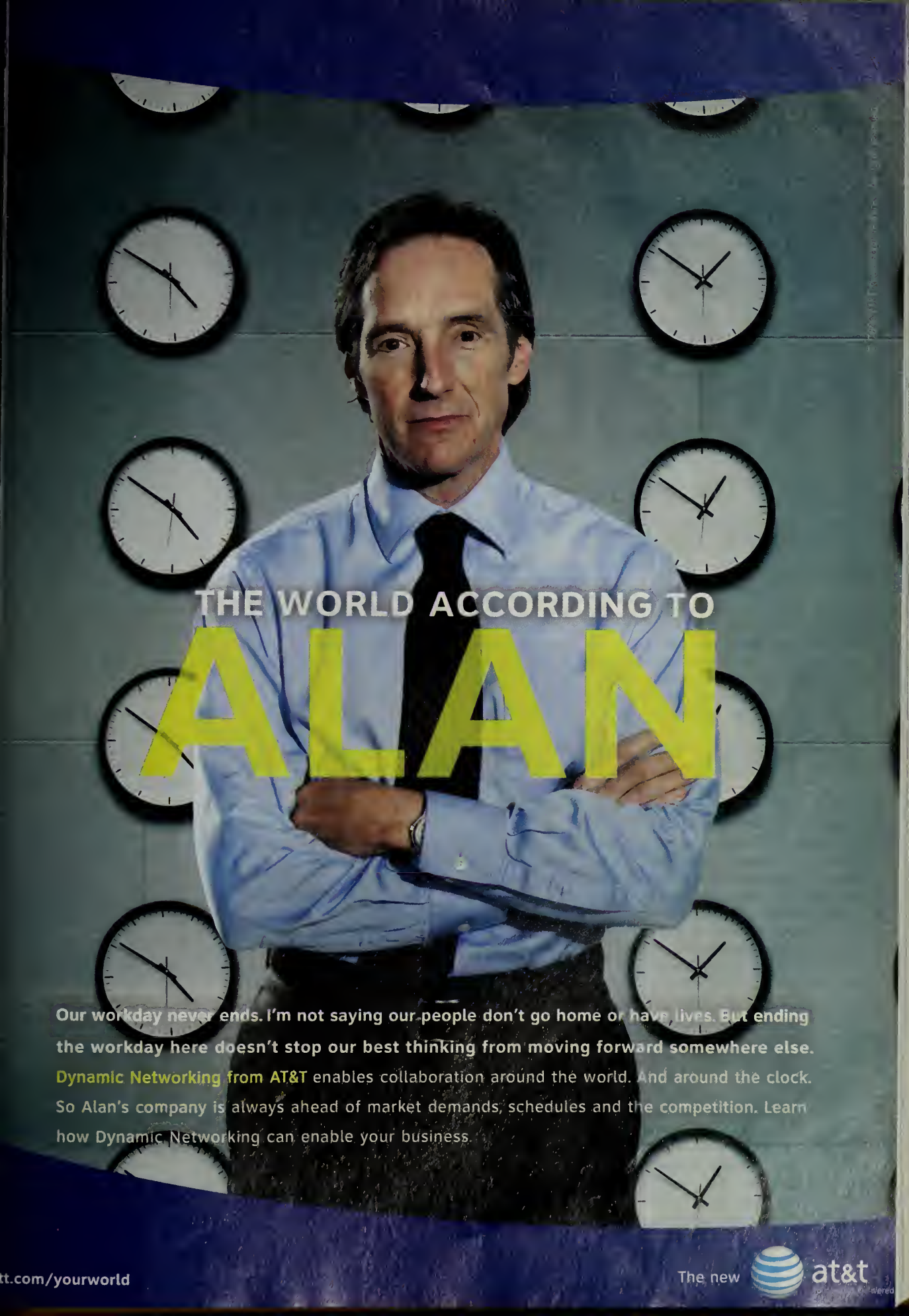
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Mack Attack

Buttressed by better earnings, a hungry Morgan Stanley is winning over critics

BY EMILY THORNTON

AMID THE ENDLESS APplause from hundreds of traders, bankers, and research analysts, one of Wall Street's fiercest warriors was becoming teary-eyed. The day was June 30, 2005. The place was Morgan Stanley's Manhattan headquarters, where John J. Mack had abruptly said goodbye to his colleagues four years earlier. The occasion was Mack's return to become CEO, replacing Philip J. Purcell, who had resigned weeks earlier after mounting criticism that he was mismanaging the famed investment bank, which once rivaled Goldman Sachs & Co. for supremacy on Wall Street.

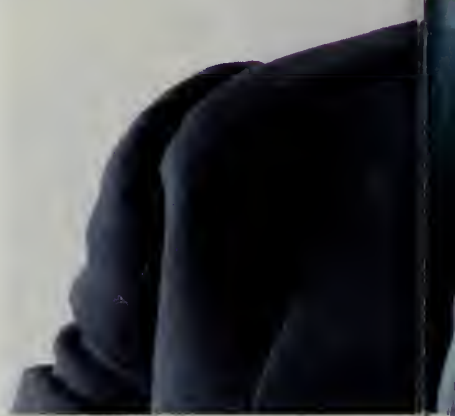
As the ovation died down and a hush fell over the room, Mack spoke of his dreams for Morgan Stanley, a firm he had worked to build into a Wall Street powerhouse since joining in 1972 as a bond salesman. As president, he helped orchestrate the $10 billion merger in 1997 with Purcell's retail brokerage giant, Dean Witter Discover & Co. Mack was so convinced the deal would reshape Wall Street that he stepped aside to let Purcell run the financial behemoth. When it became clear that he had no shot at taking over, Mack bolted in 2001 and quickly landed a job running rival Credit Suisse First Boston.

The June meeting signified that Mack was home—and in charge. "We want to be the leader and show the Street what we stand for," he told the crowd, including his wife, Christy, who had encouraged him to return. "[Morgan Stanley] is the gold standard."

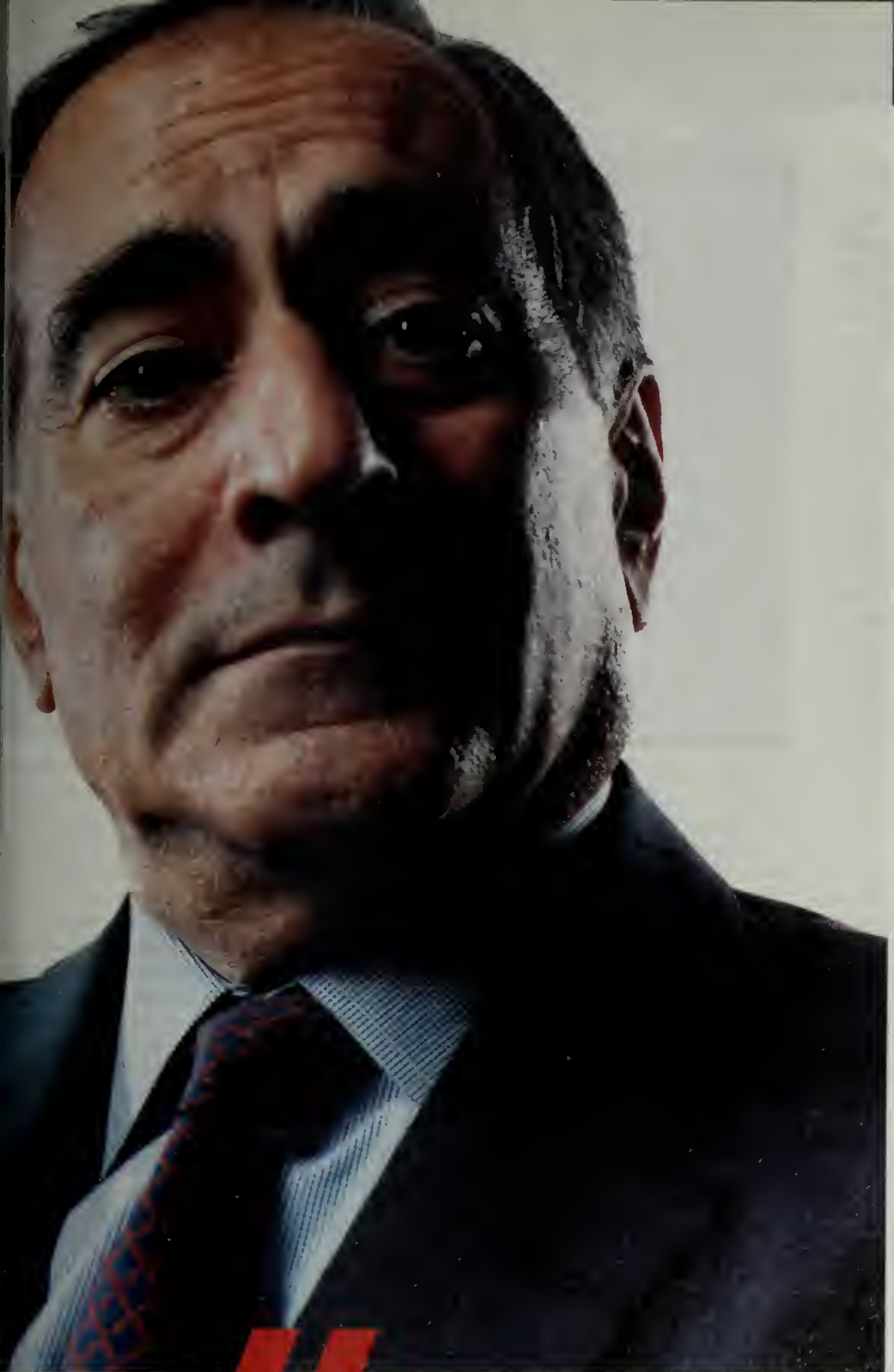
Shrinking violet

In that single moment, Mack restored much of the swagger Morgan Stanley had lost since the Dean Witter deal. But there was still plenty of work to be done—more than Mack imagined. In a speech to investors shortly after his arrival, Mack said the firm's main problem wasn't its strategy or its business mix, as was widely believed, but its culture. It had become soft and timid, missing out on growth opportunities in everything from private equity to mortgages, junk bonds to equity derivatives.

As one executive recently put it, the bank had become so risk-averse and mired in second-guessing that every time someone brought up a new idea for a business it was shot down by a "culture of no." While rivals such as Goldman, Merrill Lynch, and Lehman Brothers were making acquisitions and diving into risky but profitable endeavors, senior managers at Morgan Stanley were sending people with bold notions back to the drawing board. The cautiousness cascaded down from the top. Purcell was so worried about potential liability, says someone who worked with him, that he didn't even use e-mail. (Purcell declined to comment for this story.)



Today, Mack, 61, is taking a cudgel t that way of thinking as he embarks on radical shakeup of Morgan Stanle Whereas Purcell was a top-down strate gist and tended to hole up in his offic rarely socializing with the troops or mak ing calls on clients, Mack is drawing o his skills as a salesman and operator t make Morgan Stanley as nimble and dy namic as possible. He's doing muc more than glad-handing, though: He' building out new businesses and puttin vast sums of money at risk, both for th bank and on behalf of its clients, in an e



rt to catch up with oldman in the ever- ore-important trad- g business. And he's efing up international operations, reg- arly traveling to Europe and Asia and ating Goldman to new markets such as ubai. He's also making symbolic moves, ch as returning top brass to the 40th or, their home before the merger.

Mack's war is taking place on two nts: internally, against inertia; and ex- nally, against a superior rival that used be a peer. "If you go back to the mid- 0s, there was no question that we were the No. 1 firm," says Mack, who has promised investors that he will double the company's pretax earnings, to at least $14 billion, by 2010. "This is not rocket science."

> "If you go back to the mid-'90s, there was no question that we were No. 1. This is not rocket science"

To win the war, Mack is purging the ranks, replacing most board members and the people running the bank's divisions. He has reassigned staff to expand the asset management business and redrawn the organizational chart for the retail brokerage. "I think what he's trying to do is build a team based not on the John Mack who was there 10 years ago but on the John Mack who's here today," says General Electric CEO Jeffrey R. Immelt, who considers Mack a friend.

Still trailing

The question is whether Mack's offensive will boost the stock to shareholders' satisfaction. So far the news has been mixed. The stock is up 14% during Mack's tenure but has underperformed the Standard & Poor's Investment Banking & Brokerage Index by 14 percentage points and rival Goldman by 32 points. Year to date, however, the gap has narrowed. And on June 21 there was further evidence of momentum: Morgan Stanley reported second-quarter earnings per share of $1.86, more than double the figure of a year ago and far better than analysts' consensus estimates of $1.45, according to Thomson Financial. More important, the bank improved its results from the first quarter, whereas Goldman and Lehman turned in weaker second quarter performances. Investors sent Morgan Stanley's stock up nearly 5% on the news, and respected analyst Michael Mayo at Prudential Financial Inc. upgraded the company to "overweight" from "neutral."

Even the troubled retail brokerage and asset management businesses appeared to be on the mend, with the retail brokerage business achieving its highest net revenues since the first quarter of 2001. The results stood in stark contrast to the calls from people inside and outside the firm that Mack should dump those businesses and admit the merger was a failed at-

tempt to marry what they consider a Rolls-Royce (Morgan Stanley) with a Chevy (Dean Witter Discover). Mack insists there could be a big upside for the stock if the retail brokerage business, which now has an 11% profit margin, becomes as profitable as rivals' businesses, which have 20% margins. Asset management, he says, could take off once it starts offering more private-equity and hedge fund investments, as Goldman does.

To be sure, Morgan Stanley still has a long way to go before it can claim it's the top dog on the Street. Senior managers who are paid largely in stock might decide the anticipated boost to the share price isn't worth waiting for. "There are people who are disappointed that it's not happy days yet," says one close observer. Former Vice-Chairman Joseph R. Perella, now of Perella Weinberg Partners, is capitalizing on the uncertainty. He already has hired three senior bankers known for their close ties to European clients, including Paulo Pereira, the head of European mergers and acquisitions.

Sudden switch

Some analysts, meanwhile, wonder whether Morgan Stanley is equipped to ramp up the risky trading business so aggressively. "You can't just throw a switch and make it happen," says Merrill Lynch financial-services analyst Guy Moszkowski. And there are worries that Mack's embrace of risk might drive clients away. His approach "is going to make [Morgan Stanley] a very different kind of firm," says one former executive. The fear: that some clients will turn to boutique investment banks such as Perella Weinberg for objective advice, free from potential conflicts of interest with the trading desk.

Some worry that Mack's embrace of risk might drive clients away

Yet for all the consternation, there's no doubt that Mack is making Morgan Stanley gutsier. In the past 12 months it has soared from nowhere to become one of the top investment banks financing private-equity deals, business once avoided as too risky. Morgan Stanley was one of three leading advisers on Kohlberg Kravis Roberts & Co.'s $5 billion public offering on the Euronext exchange in Amsterdam in May. "They're changing," says KKR's Henry Kravis. "They're doing some financings for us that are very innovative." Morgan Stanley will "be able to establish forward momentum on a number of fronts they didn't have before John got there," says Stephen A. Schwarzman, CEO of the Blackstone Group.

Mack's Plan

INVESTMENT BANKING Become a top adviser for private-equity firms and corporations on everything from mergers to stock and junk bond offerings.

TRADING Expand repertoire of products traded, both for clients and the firm's own books.

RETAIL BROKERAGE Boost profit margins to 20% from 11% by wooing and training more productive financial advisers. Offer more investment products that will attract wealthy investors.

ASSET MANAGEMENT Gather more assets by expanding the number of product offerings.

CREDIT CARD Expand Discover Card's reach overseas and in debit payments.

Data: *BusinessWeek*

Decisions are also being made more speedily. "I can lob a phone call in and say 'this needs board approval,' and three days later we're in place to get something done," says Neal Shear, co-head of institutional sales and trading. That's different from 2004, when Shear proposed to senior managers that Morgan Stanley bid for the petroleum products distributor TransMontaigne Inc. to bulk up its commodities-trading business. Nothing happened. When Shear brought the idea to Mack in March, he "intuitively understood what we were talking about," says Shear, and in little more than a week, Morgan Stanley made an offer. (On June 19 its $567 million offer was tentatively accepted.) Rair Simonyan, chairman of Morgan Stanley in Moscow, has had a similar experience. "It's just a call or an e-mail, and I can reach whoever I need," he says.

More than anything, there's a new openness at Morgan Stanley. By many accounts, Purcell limited the exposure of his executives to the board. Mack insists his entire management team attend meetings and socialize with members. "John has gone out of his way to make sure the board has exposure to a wide variety of people," says C. Robert Kidder, a principal at private-equity firm Stonehenge Partners Inc., who has been on the board for many years.

Slowly but surely many of last year's critics are being converted. In June one of the firm's top brass in capital markets, Jo Anda, returned to Morgan Stanley fr months after leaving for Perella Weinber Even Moszkowski, who has a "neutra rating on the stock, acknowledges th Morgan Stanley is becoming more cor petitive. "Whenever a top franchise play reenergizes itself, it's going to be felt Moszkowski says.

A lot is riding on Mack's turnarour strategy. If he fails to boost the stock, Mo gan Stanley could end up as one of th hunted instead of being a hunter. Son speculate that JPMorgan Chase & C could try to reunite the House of Morga by buying Morgan Stanley.

For Mack to succeed, he must rekind bankers' killer instincts. When clients t him they haven't heard from his banke he blows up. "That kind of stuff drives n crazy," he says. Recently he delivered vivid pep talk, telling bankers to get ma "It should bother us when we lose bus ness," he said. "We can't lose a piece business and [then] make excuses. W should be angry about it and think abo how we're going to get [it] back."

But the fiery leader is also warm and e gaging. He lavishes attention on employe at events ranging from strategy breakfas to dinners with their spouses at the Mo gan Library & Museum. He introduc himself to anyone he doesn't know whe he rides the elevators and walks the floo During a stroll in January, he overheard group of traders discussing whether h alma mater, Duke University, could be the University of Maryland in a basketb

ıe. He bet on Duke; the traders owe
dinner.

Mack's passion has served him well on unlikely Wall Street odyssey. The sixth of Lebanese immigrants whose father a grocery store in Mooresville, N.C., ck's first job in finance was as a clerk at hall brokerage during his junior year at ke, after a cracked vertebra made it im- sible for him to continue on his foot- scholarship. Mack rose through Mor- Stanley's ranks to become president 993. He earned the nickname Mack Knife for his cost-cutting prowess while managing the fixed income division, and he lived up to his billing at CSFB, where he cut 10,000 jobs and returned the bank to profitability. (CSFB's board didn't renew Mack's contract in 2004 after a dispute over the firm's direction.)

Even before coming back to Morgan Stanley, Mack sensed his job might be complicated. For weeks people hoped the board would bring him in to make peace with the senior executives who had fled in what some called Purcell's "Monday Night Massacre" (box). But on the day his new job was announced, Mack told the troops that while he planned to reach out to the people who left, he would rehire them only on his terms. "We don't want individual agendas," he said, but rather "team players" who believe in "one firm." Those who left still resented Zoe Cruz, then acting president, for backing Purcell and refused to work with her. Mack didn't budge. "I'm not going to let anyone put a gun to my head and tell me they'll come back only if I shoot someone they don't want to work with," Mack says. (Cruz declined to comment.)

Only on his terms

In some cases, Mack realized, only outsiders could help. Case in point: He badly needed someone to fix the firm's retail brokerage business. On Day Two of his tenure he called James Gorman at Merrill Lynch. Gorman, who had led Merrill's retail brokerage business for years, had just been moved to a more general strategy position. Mack started sweet-talking him. Lure No. 1: a chance to return Morgan Stanley to its former glory. Lure No. 2: Gorman would have free rein. The only catch was that he couldn't start work until February, when his Merrill contract expired. Mack agreed, and he primed the pump by laying off 10% of the firm's least productive brokers before Gorman got there.

At the same time Mack was wooing Gorman, he was commissioning Chief Financial Officer David H. Sidwell to draw up a list of everything that needed to be decided on. Within two months, Mack had reversed the spin-off of the Discover credit-card unit, announced plans to sell Morgan Stanley's aircraft-leasing business, and persuaded three new directors and some executives he had taken with him to CSFB five years earlier to return, while accepting resignations from other top managers and directors.

After that flurry of decisions, Mack tried to take a break to clear his head but cut it short when bankers said they needed him in Beijing. Mack darted there to have dinner with senior managers working on the initial public offering

Where They Are Now

On Mar. 28, 2005, former Morgan Stanley CEO Phil Purcell orchestrated what became known as the onday Night Massacre. He redrew e firm's organizational chart, aming chief administrative officer ephen S. Crawford and fixed- come division head Zoe Cruz co- esidents and leaving institutional ecurities group head Vikram andit in the cold. The next day stitutional equity division head ohn P. Havens walked out the door. ot long after, vice-chairman Joseph Perella, investment banking division head Tarek Abdel-Meguid, and President Stephan Newhouse said goodbye. The shakeup weakened Morgan Stanley. Eventually even Purcell and Crawford departed, albeit with golden parachutes. Pandit and Havens have started their own global multistrategy hedge fund called Old Lane. Perella and Meguid founded a boutique investment bank called Perella Weinberg Partners. Newhouse is a director at a newly formed Bermuda reinsurance company called Harbor Pointe Re Ltd. and is understood to be joining the boards of two other companies, one in China and the other in Russia. Purcell is investing his own money in small financial services companies at Continental Investors in Chicago. Cruz remains a co-president at Morgan Stanley and the most powerful woman on the Street.

PERELLA

CRAWFORD

PANDIT

NEWHOUSE

of China Construction Bank Corp. The following day he met with five clients. It was the first of many trips; in October alone, he traveled to Europe, Asia, and Russia. His message was simple: He was taking the firm "off autopilot," as he told one group of employees in Tokyo.

Back at home, though, Mack was getting frustrated. He had asked all the division heads to size up their performance vs. competitors. He had no idea how many gaps there were, or how big. When he asked about the firm's business with private-equity firms, the Street's biggest-paying clients, he was told that Morgan Stanley didn't cover them much because they required junk-bond financing and commitments of capital from the firm's own balance sheet, things Morgan Stanley simply wouldn't do.

Tensions exploded at a meeting of senior managers in suburban Westchester County, N.Y., in October. Mack wanted to discuss how the firm would achieve its goals. Instead he got a flood of complaints pent up over seven months of upheaval. "It was a bitch session," says one senior executive. Mack let staffers go on and on about all the opportunities they had missed in recent years.

"Think like owners"

It was becoming a familiar theme. A couple of weeks before, in Japan, a client had told him that he had once approached Morgan Stanley about a deal in 2003 and never heard back. Mack called Cruz for an explanation. "She said: 'John, we analyzed it and we analyzed it. We just never made a decision.' She called it 'analysis paralysis,'" Mack recalls. And in December, when he signed off on Discover's purchase of a British credit-card company called Goldfish Financial Services for $1.8 billion, he learned the idea had been in the works for years. Even the firm's stock ticker hadn't been changed to reflect that the bank had switched its name to Morgan Stanley—from Morgan Stanley Dean Witter—years earlier.

Mack realized he needed people to be entrepreneurial, the way they were when the company was a private partnership. "Think like owners" became his mantra. Mack wanted bankers to seize opportunities, not miss them, and for heaven's sake not be afraid to present them to senior executives. He even took top managers to General Electric Co.'s training facility in Crotonville, N.Y., in January for a session on leadership. Afterward they met with Jeff Immelt and team and picked their brains.

In July, Morgan Stanley will be advising on Russia's largest IPO

Mack also tried to lead by example. Around the same time he told investors that Morgan Stanley was going to pursue acquisitions to boost revenues, he opened talks with the hedge fund FrontPoint Partners and, later, asset manager BlackRock Inc. about combining forces. In both cases, the companies asked for more than Mack was willing to pay. (In February, Merrill Lynch merged its $539 billion asset management business into BlackRock for a 49.8% stake in the company.)

John J. Mack

BORN Nov. 17, 1944, Mooresville, N.C.

UPBRINGING Youngest of six boys; father, Charles Machoul, owned a grocery store. Mother cooked for sick people in community.

EDUCATION BA in History, Duke University.

POSITION Chairman and CEO of Morgan Stanley since June 30, 2005.

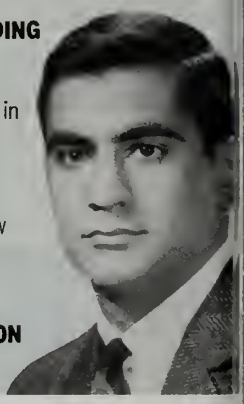
FIRST JOB While an undergraduate at Duke, worked at a small brokerage house, earning $365 a month.

FINANCE CAREER Joined Morgan Stanley as a bond salesman in 1972. Became president in 1993. Left Morgan Stanley to run Credit Suisse First Boston in 2001 and then became co-CEO of the Credit Suisse Group. Left CSFB in June, 2004, in a dispute over the firm's direction. Served briefly as chairman of the hedge fund Pequot Capital Management.

FAMILY LIFE Married to Christy, co-founder of the Philanthropic Collaboration for Integrative Medicine in Minneapolis; three children.

WHAT HE'S READING A book about Mao and another about the oyster industry in New York.

INTERESTS Golf, basketball, Duke University, and New York-Presbyterian Hospital.



THE GROCER'S SON

By the spring, Mack was starting to see signs of progress. Gorman was making real strides in overhauling the retail brokerage business. Gorman had set about laying off 700 more people and redesigning everything from customer statements to the way brokers are trained. He created a special team to focus on finding more investment products from inside and outside Morgan Stanley that would attract wealthy investors. He expanded the company's retail banking services and small-business lending programs. And he started devising a way for bankers to easily send clients to the firm's financial advisers, and for advisers to send bankers potential deals.

The asset management business was also showing signs of life. Instead of managing the division for profits a cutting costs, Mack wanted its n head, Owen D. Thomas, to expand it, especially its private equity and hedg fund offerings. Thomas started encou aging employees to come up with n ideas. He brought over the head of t firm's prime brokerage business cateri to hedge funds to help him brainsto about potential investments in hed funds and teams he might be able to w to Morgan Stanley. In the second quart the division launched nine new fun Thomas also brought in some teams hedge-fund managers and purchased Boston fund.

When asked recently about the m discouraging moment of his first ye Mack said it was the death in April of H ter F. Karches, once the head of instit tional securities and one of Mack's cl est friends at Morgan Stanley. He hel meeting at which he shared with th sands of staff members Karches' phil ophy that making a wrong decision "unfortunate" but that not making a d cision is "unforgivable."

It's a lesson Mack has taken to he as he races to make a nine-year-d merger work. "I say to Christy that I f like I'm in my 30s, but I know I'm 6 he says. "I can't do this forever. And s says: 'John, are you nuts? It's what y love.'" Mack concedes her point. "I li the action. I like the people. I li the business." But, he adds: "It's a of work."

–With Stanley Reed in London, Dia Brady in New York, Jason Bush in Mosc and Frederik Balfour in Hong Ko

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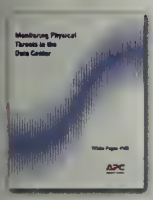

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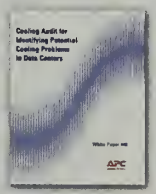

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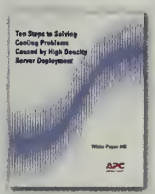

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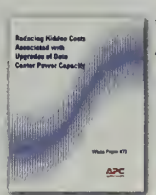

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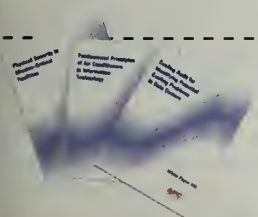

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The Dilemma Vexing Big Media

All digital content under one umbrella? Corporations fumble for an answer

BY TOM LOWRY

IN AN ERA WHEN MEDIA COMPANIES are under the gun to distribute their movies, TV shows, and publications in new ways, MTV Networks saw itself making a bold statement last October when it appointed a 34-year-old executive to be its first-ever chief digital officer. The executive was to have a key role in helping brands such as Comedy Central, Nickelodeon, and VH1 tackle broadband and wireless efforts. The anointed one: Jason Hirschhorn, a smart, charismatic former entrepreneur who had been advising on online projects at the company for about five years.

Oops. Just seven months after Hirschhorn's promotion was hailed as groundbreaking by MTVN, his departure was quietly slipped into the trade press. In a prepared statement in late May, CEO Judy McGrath praised Hirschhorn for his work and called him a "visionary." MTVN officials declined to elaborate further.

What went wrong? Shortly after Hirschhorn took on his new role, it had become clear that the 25-year-old media giant, which always prided itself on being a pioneer, had a problem. Many of MTVN's businesses were already deep into their own digital plans, such as the online broadband channel MotherLoad from Comedy Central. In his earlier incarnation as a sort of internal consultant, Hirschhorn had been a helpful ideas person. But as the top guy, he was seen as a meddler, rankling executives on the front lines. "We are a very decentralized place where we are told our mission is to supersize our brands," says one executive. "Jason was a polarizing figure."

Faux pas like MTVN's are clearly front and center in the minds of executives the days. That's because the biggest challen in many large companies over the next fe years—and not just in media—will be wh wins in the race for digital supremacy. T internal debates go something like this: I we make a high-profile hire at corpora and give the person a fancy digital title th will impress Wall Street? Or do we take chance on closer-to-the-ground techies our business units who may be less ris averse and understand more of what o customers really want? How those hi stakes decisions get handled will go a lo way toward determining not only care paths but also whether billions are ma or lost, particularly in media. "For [th industry now," says Scott Anthony, a ma aging director at consultancy Innosigh "this is a decision that companies kn they need to get right—and right away."

GOING FOR THE GURU

IT IS STILL WAY too early in the game f anyone to declare a proven formula. B fearing duplication of efforts, many m dia companies are leaning toward ce tralizing, naming a high-ranking digi guru. That has created a cottage indust for executive recruiters and consultar who are reaping big fees for deliveri hotshots to traditional media and oth industries. Kelvin Thompson, chief ma keting and strategy officer at executive r cruiting firm Heidrick & Struggles, sa he travels around the globe scouring f New Media hires. "Everyone wants

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ow how to interact with those new systems out there," says Thompson. That is why CEOs are looking for direct dback from a digital consigliere. Betty nen, CEO of Lifetime Networks, says she ently hired Dan Suratt, who helped cre- the nbcolympics.com nchise for NBC Universal, her top digital person be- use "we needed help in pri- izing the overabundance pportunities." Yet last De- nber, Cohen promoted ad es executive Lynn Picard to post of executive vice- sident for interactive en- ainment. Cohen says she doesn't fore- any conflict: "We will have a laborative understanding." For Eric W. rier, the CEO of Reader's Digest Asso- tion Inc., who on June 19 hired Time rner's Jodi Kahn to be president of dig- media, his decision to go central was ut "having someone here who was nking 24/7" about these new platforms l who could forge new partnerships.

BIG HAT AND NO CATTLE"

RLY ENTHUSIASM surrounds these vest hires, but a script more reminis- t of the MTVN experience is being yed at other companies over, what else, f. "The problem is that a person gets lowed with responsibility but no au- rity," says Mark Piesanen, a senior nager in the media and entertainment ctice at Deloitte Consulting LLC. "You e somebody a big hat and no cattle." at lack of clarity appears to be plaguing C Universal. In December, Beth Com- ck, an executive at parent General ctric Co., was appointed to head digi- media at the entertainment unit of GE, third person in that role in two years. anwhile, David Zaslav, president of C Universal Cable, had assumed many ital responsibilities before Comstock's arrival and is still often seen as the face of NBCU's New Media efforts. Under him is Jean-Briac Perrette, a senior vice-president for new media and the chief financial officer. What's more, Jeff Gaspin serves as president of digital content and cross-network strategy for NBCU Cable Entertainment, a programming arm. While it may seem confusing, "it's not anarchy," insists Comstock. "You have to have a deal, oversees the media conglomerate's digital strategies. He meets regularly with division executives such as Ned Desmond, president of Time Inc. interactive and formerly head of the magazine *Business 2.0*. It was at these biweekly brainstorming sessions with Desmond and other managers that Time Warner decided to relaunch the financial Web site CNNMoney.com last January. Now centralized digital operation to get the company to move fast. At the same time, you want every unit to have autonomy but with a level of accountability."

It all has a familiar ring, going back to the first Internet boom. A lot of executives have long memories of early, disastrous attempts to centralize Internet operations. Those embarrassments are a factor in the way some companies are proceeding today. Before its painful combination with AOL, Time Warner Inc. created a unit called Time Warner Digital Media to handle all matters of the Internet. But its failure to create any tangible products in part motivated then-CEO Gerald Levin to embrace AOL.

Today, Time Warner has decided not to hire a top digital executive. President Jeffrey Bewkes, once a bitter critic of the AOL

PLAYBOOK: BEST-PRACTICE IDEAS

Finding the Sweet Spot

Media companies are wrestling with how best to formulate a digital strategy and get it right the first time. Here are a few pointers from Innosight, the consulting firm founded by innovation guru Clayton Christensen:

BE A HYBRID Give some freedom to the digital folks at local units while the people at headquarters keep an eye on the big revenue picture.

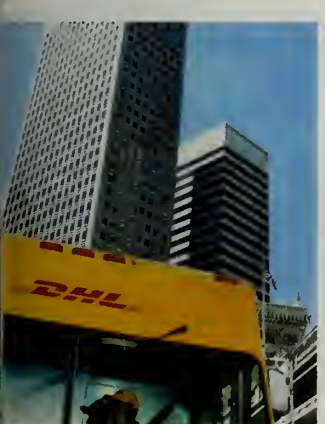
FOCUS ON NEW AUDIENCES Try to reach the people you haven't been able to in old media. For example, kids don't read newspapers anymore, so publishers should find ways to connect with young folks—not by giving them a product they've shown they don't want.

TAP IN TO A NEW BUSINESS MODEL Revenues from digital should not mirror those from your old media sphere. Forget about cost per 1,000 advertising models. Think about generating leads and paid search, for instance.

BRING IN THE RIGHT OUTSIDE VOICES Hire people who live and breathe in a digital world and understand its differences from the old world. Recruiting from Google and Yahoo! might be a start.

COME TO TERMS WITH CHANGE Toss out old notions of product cycles. For a newspaper, that means thinking beyond the nightly print run and more about continuous publishing. For TV, say hello to the five-minute mobisode.

Data: Scott Anthony, Innosight



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Other companies are treating their operations as petri dishes, watching closely to see what will grow. One is Walt Disney Co., also *sans* a digital guru. It learned its lessons the hard way. In 2001 it shut down its Internet business Go.com and took a $790 million charge to earnings. Robert A. Iger, who as Disney president announced Go.com's demise, says that upon being elevated to CEO last October, he decided he did not want a one-size-fits-all strategy. "We knew with things moving so fast, and it all being so new, there would be a lot of trial and error," says Iger. "We felt creating a corporate template, with its rigor, could be a mistake."

Disney learned its digital lessons the hard way

Instead, Iger wanted to get everybody at the company thinking about making technology work for Disney. Through speeches and internal meetings, the CEO emphasized that technology should do three things: make products better (football in high-definition TV); deliver programming in new ways (the hit show *Lost* on iTunes, one of his first moves as CEO); and understand customers better (one-on-one feedback from free streaming of prime time shows on ABC.com). Now every week Iger holds a catered lunch for his direct reports in the headquarters in Burbank, Calif. Over sandwiches and bottled water, the execs swap digital ideas that bubble up from staff. "This is still all an experiment," says Iger, "so why not explore what is possible?"

At MTVN, meanwhile, digital efforts have not slowed since Hirschhorn left. The MTV channel is creating "MTV Viewser Labs," in which its programmers and biz types meet with media buyers to tailor ads on all distribution platforms to have the look and feel of the programming they're next to. It was the brainchild of MTV President Christina Norman. CEO McGrath and her team are still trying to determine the best approach to digital at a corporate level, say executives, especially now that COO Michael Wolf is being tapped for much of the broader New Media thinking.

Sooner or later, however, the dilemma over whether to go local or top-down will stop being a headache, says James Citrin, the top media headhunter at search firm Spencer Stuart. "In the end, everything will be digital."

Can an Outsider Tame the Tour?

Disney alum Etienne de Villiers aims to make men's tennis a hot ticket again

BY DOUGLAS ROBSON

IN FEBRUARY, AT THE OPULENT, seven-star Burg Al Arab Hotel in Dubai, the titans of men's tennis suddenly glimpsed an end to the years of inertia that have plagued their sport. There, new ATP Tour Inc. Chairman and President Etienne de Villiers had convened a powwow with four of the game's top names, including its biggest star, Andre Agassi. Flanked by No. 1 Roger Federer, No. 2 Rafael Nadal, and 2000 U.S. Open champion Marat Safin, Agassi pressed de Villiers about the ATP's stagnant fortunes. "What I want to know," Agassi said, according to those present, "is whether we are in the same play with different characters, or do we have a new plot and actors?"

De Villiers was taken aback but didn't flinch. The Rhodes scholar and former Walt Disney Co. executive calmly volleyed Agassi's shot, saying he didn't need the ATP job to fatten his wallet or stroke his ego. De Villiers meant to fix the cracks in the sport even if his moves exacted a short-term price for players and tournaments alike. "I have no agenda here other than to make a difference," de Villiers said to Agassi.

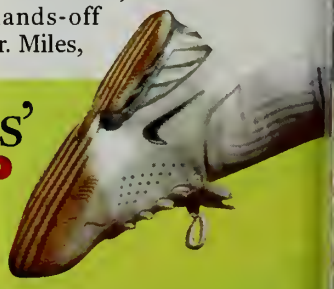
He's already doing that. A tennis outsider who grew up in a segregated South Africa, de Villiers has taken on the army of entities that rule the perennially embroiled sport. The ATP is the gover ing body of men's tennis, staging a c cuit of tourneys around the world. constituents are the players and the tou naments, which co-own the organiz tion. But the most important events the year—the Australian, French, a U.S. Opens, and Wimbledon, known the Grand Slams—are owned and run their respective national federatio The Davis Cup and Fed Cup, the ma and female nation-to-nation compe tions, fall under the aegis of the Interr tional Tennis Federation. And the play are in essence free agents, able to choo what events they play.

DISASTROUS DEAL

THIS MESSY STRUCTURE, de Villi believes, has led to an arduous, month schedule for players and made hard for fans to follow clear and s penseful story lines. "Tennis has change, not because it's bad, but becau it's so damn good, and we're not rea ing enough people," he says. To that e he's using research-based marketing brand the ATP as never before—and questioning some of tennis' most h lowed traditions.

De Villiers inherited an organizati molded by the 15-year reign of form CEO Mark Miles, a hands-off leader. Miles,

De Villiers' Bold ATP Agenda



o retired in December, oversaw a dis-rous $1.2 billion TV and marketing nts deal in 1999 with Swiss company Marketing. ISL imploded two years r, forcing the ATP to scramble for v sponsor dollars and siphon off ze money to fund the players' pension n. The tour has stabilized since, but ze money and TV ratings have re-ined static and are small npared with golf, the sport against which tennis is most often measured.

While the Grand Slams continue to boost prize money, the ATP's total purse has dipped to 2003 levels. The estimated figure for the tour's 64 events in 2006 is $55.8 million, virtually the same as three years ago and 5.3% below 2000 levels. TV ratings are lackluster: For instance, last year's final at Wimbledon between Federer and American Andy Roddick rated a 2.5 on NBC, the lowest in five years.

De Villiers didn't even know if he wanted the job when his friend Richard Davies, head of the tour's sponsorship arm, came calling. After 15 years at Disney, where among other positions he headed the international TV unit, he founded a $1 billion private-equity fund. (His partners are still running it.) That left him time to golf, ski, and focus on his massive collection of music, which includes an iPod stuffed with more than 9,500 songs.

So why would a wealthy man, married to his childhood sweetheart, take on the task of governing the ATP—especially after nearly dying during surgery for prostate cancer a year ago? Because, he says, he's a sports junkie who saw the chance to elevate the game he grew to love as a child when his mother tore up their garden in Pretoria and built a tennis court.

SHORT FUSE

A RACONTEUR who likes to quote people ranging from Malcolm X to Tolstoy to Woody Allen, de Villiers is also a hard-nosed businessman unafraid to shake up the status quo. Those who have seen him in action say he has a short fuse and shows no compunction about throwing his power around. As one tennis official puts it: "He's scaring the hell out of some people."

De Villiers certainly has big ambitions. In March he hired former Scottish Rugby Union CEO Phil Anderton, a veteran of Coca-Cola Co. and Procter & Gamble, as the ATP's first-ever chief marketing officer. He has stated his desire to almost double tour prize money, to $100 million, by 2010 by boosting sponsorships, ticket revenue, and winning a better TV contract, among other sources of income. He is pushing to begin events on Sunday rather than the traditional Monday to lure more weekend audiences. De Villiers intends to make this voluntary for all tourneys in 2007. He wants more combined events with the women's tour and is even toying with changing the hallowed single-elimination format in favor of more round-robin draws, guaranteeing audiences and broadcasters marquee players at fixed times for more than one match.

But there's one task facing de Villiers that's the equivalent of handling a 150-mile-an-hour Roddick serve: transforming the tennis calendar so it's more player- and fan-friendly. He's locking horns with the federations that control the Davis Cup, the Grand Slams, and regular ATP events to create regional mini-series leading into the Grand Slams, modeled after the U.S. Open Series, a North American summer hard-court swing that culminates with the U.S. Open. He also wants to revamp the nine Master's Series events—contested only by the top players, and spread across the calendar and the globe—into a comprehensible package commanding more TV money.

Sounds good, but De Villiers has learned how hard it is to bring change to a sport with no overarching body and multiple entrenched interests. "That has been the biggest 'aha,'" he says. "It's going to be a lot harder than I thought."

Some observers think de Villiers may get worn down. The skeptics include players who have heard talk of change before. "He's got some things he wants to do," says Federer, who begins his title defense at Wimbledon on June 26. "We'll see if they're really going to happen."

FEDERER His star power could help

UBLE prize money, to $100 lion, by 2010.

EATE mini-series of tourneys ding up to Grand Slams.

AGE more combined events with women's tour.

BEGIN tournaments on Sunday instead of Monday to capture more weekend audiences.

CHARGE UP the sport's marketing. He hired the ATP's first chief marketing officer in March.

TRANSFORM the arduous 11-month tennis calendar so it's more player- and fan-friendly.

I'M WORKING HERE
Working virtually from New York's Cafe Ari, via Wi-F

Square Feet. Oh, How Square!

The rise of mobile workers has companies unloading space and rethinking what's left

BY MICHELLE CONLIN

CHANCES ARE THAT ON any given day up to 40% of your colleagues are not in the office. Instead they are working in rumpled T-shirts on their sofas, long-hauling it to Asia for client meetings, or mooching Wi-Fi and power in some café. The professional class is going bedouin, as some in Silicon Valley say.

Left behind are dead zones of empty cubicles and dark offices. The modern employee may be post-geographic, but most corporate offices are of the Analog Age. Two issues emerge: dealing with the space pileup in the short term and completely reimagining the use of all that pricey real estate. As it is, space is allotted by title, not function. Square footage is based on rank, not attendance. It's supposed to be about open source, but everywhere it's walls. We're told to work together, but offices are designed for working alone. We're asked to collaborate, but when on-site there's no place to gather without floor sitting, too-close-for-work bodily contact, or standing room only. Our performance reviews grade us on thinking outside the box. But we work in the box.

Thus the great office space rethink going on at a wide spectrum of companies including Cisco Systems, Procter & Gamble, and Bank of America. Corporations spend more on space than on anyth else except people. But large swaths of fice infrastructure are turning into wast assets. And the workplace ghost tow will likely grow. A recent Boston Cons ing Group study found that 85% of exe tives expect a big rise in the number of cation-agnostic workers over the next years. The study also found that m companies aren't applying the same orous analysis to their office space as t are to their strategic functions. Those t do reap big rewards. By the middle of r year, Hewlett-Packard Co. expects to s $230 million of annual space expense

While the no-collar nomads are giv companies a way to cut their pricey co mercial real estate costs, they are also abling them to reconfigure what's over. By dumping square footage, neg ating flexible leases, reconfiguring sh ow space, creating movable, everythi on-wheels offices, and designing "gett away without going away" areas, com nies can better leverage their talent inspire innovation. Cisco Systems Inc. rent and workplace service costs by 3 and saw productivity benefits of $2.4 lion in 2005 from just such an overh Estimates Charles Grantham, co-foun of Work Design Collaborative: "We lieve companies could get as much 30% to 40% cost savings."

Paradoxically, as we disperse more, need to gather in an ideal environm

ensifies. So the rethink also includes a wing appreciation for the "social architecture" of offices. Architecture and interior design firms such as Archideas Inc. creating offices for companies by pping the informal networks in organtions and then structuring space und concepts such as who employees nce ideas off of and who they like to ng out with.

The idea is to create the neighborly sh-up of a Greenwich Village sidelk. The new Jump Associates space in n Mateo, Calif., designed by Archideas ust that, so much so that when anyone ers the office, the receptionist hollers, ey everyone, Joe is in the house." noever's around shouts back, "Hi, !" Employees are free to decorate their as as if they were MySpace pages. Peo- working on projects can move walls, sks, and whiteboards as needed. The dible infrastructure means Jumpers n create an office as private as an oldnool CEO's or as public as a newsroom.

R STOOLS AND BRASS

APPING HELPS managers throw reurces at the spaces where people conct rather than where they work alone—consultant-speak, the "we" spaces her than the "me" spaces. So parts of np's office actually feel like a café, come with good coffee and food, sans cash gisters. When Procter & Gamble Co. remped one of its Cincinnati offices rently, the company talked to staffers be- the architects arrived. They asked ople in different groups where they felt the most open and creative. One posse of product packagers, accustomed to starting new plants in foreign countries, said they felt most at ease talking with other people in a bar. (They spent a lot of time in international hotels.) So P&G built them one—with caffeine instead of spirits—complete with lots of bar stools and brass.

Deloitte's "hoteling" solution divvies up services à la carte

The boundaries of what's acceptable are expanding in the outer world as well. There's a whole new scene going on with mobs of corporate beatniks swarming cafés during business hours. "If my people aren't in the design studio, I'm not sweating it," says James Ludwig, director of design for Steelcase Inc. "All things are becoming output-oriented, rather than location- or time-oriented."

With the global mobile workforce expected to grow by more than 20% in the next four years, some companies are already making radical changes. Deloitte & Touche is rolling out "hoteling" in its offices around the world. The term refers to the practice of having mobile employees dial up an office concierge and reserve space as needed rather than hogging prime real estate when they rarely make an appearance in the office. Deloitte's version comes with do-anything-for-you concierges who roam the halls, trays filled with whatever office supplies you need that are refilled nightly, and plugs specially outfitted for laptops, iPods, and cell-phone chargers. The spaces are designed with an "Exchange" right off the elevator with support services on one side and TVs, computers, and café services on the other.

At its most extreme, the great office shuffle is pushing companies to consider whether they should even own a headquarters. Could they sell the asset, lease back less space, and then use the capital more wisely by investing it in their core competencies? Erik E. Kolar, CEO of Wayne (Pa.) real estate investment firm Patriot Equities, works with companies to divest their real estate holdings. He says the Sarbanes-Oxley Act's increased transparency requirements are driving companies to get rid of idle assets.

Is an infrastructure-free company in our future? Coghead, a Web-based business application developer in Mountain View, Calif., comes pretty close. Save for the laptops and cell phones, the 20-person company has virtually no hard assets. Coghead's Redwood City (Calif.) warehouse office space is on a monthly lease. Servers, e-mail programs, and a wiki are all provided by low-cost, third-party sources on the Web. Chief Technology Officer and founder Greg Olsen says that if a major earthquake or Avian flu outbreak occurred, the company could up and move anywhere within a day. As he puts it, kind of like a clan of neo-bedouins before a sandstorm.

My Office, The Coffeehouse

As technology untethers workers from the workplace, more suits with cell phones are setting up shop in free Wi-Fi cafés. Some of the best:

SAN FRANCISCO
Cafe du Soleil

■ Landing pad for SF's technigentsia. Delightful alternative office, except from 5 to 8 p.m., when gruppie parents descend with their ill-behaved spawn. Watch your tongue, though: It's a favorite of Valleywag gossiper Nick Douglas.

SEATTLE
Zoka Coffee Roaster & Tea

■ The three-man team at software maker Delicious Monster uses Zoka as its headquarters. Giant desks, award-winning baristas.

CHICAGO
The Grind

■ Nirvana for Internet moochers. Free Wi-Fi. Tons of power outlets. Serves up the "crack" of coffee. Friendliest staff ever.

NEW YORK
Cafe Ari

■ This Greenwich Village boho enclave got overrun by the professional class the day they put out the free Wi-Fi sign. Says the staff: If you make this your virtual cubicle, please keep the orders flowing.

WASHINGTON
Steam Cafe & Lounge

■ So much the new office that it's better for working than socializing. Quiet, wonky vibe. No cell-phone jabbers, please.

Free Trade Can Be Too Free

Economist Joseph Stiglitz makes the case against unfettered globalization

BY PETER COY

AS AN ECONOMIST, Joseph E. Stiglitz has credibility galore. The Columbia University scholar shared a Nobel prize in 2001 for helping develop the influential field of "information economics." Before that, he was President Clinton's top economic adviser and then the chief economist at the World Bank.

Now, though, using his full intellectual firepower, Stiglitz is attacking the Economic Establishment from within. The key issue: Would the economy benefit from more government intervention? Mainstream economists, by and large, are uncomfortable with the idea of expanding the government's economic role. Even those who think of themselves as liberal tend to favor markets wherever possible.

But Stiglitz argues that targeted government action would improve the functioning of the economy. In his view, information economics—the field that he helped create—demonstrates that unfettered free markets can often break down, leading to problems ranging from unemployment to inadequate basic research to underlending by banks. "He's a strong voice and conscience for what true economics says about things, rather than the snippets of economics that are convenient for one party at one moment," says New York University visiting scholar Jason Furman, a past Stiglitz collaborator who was director of economic policy for the 2004 Presidential campaign of Sen tor John Kerry (D-Mass.).

Stiglitz' arguments have been findir receptive ears in the U.S. and abroad. It not just his ideas: He speaks and writ in a way that resonates with ordina people. "He's read by students, by pol cymakers, by media. He definitely is or of the most influential economists glol ally, all over the developing world pa ticularly," says Turkey's Kemal Dervi administrator of the United Nations D velopment Program.

GAMMA QUADRANT?

AT THE MOMENT, Stiglitz' No. 1 issue trade. He attacks the so-called Washin ton Consensus, which prescribes privat zation, fiscal discipline, deregulatio and free trade as the cure for the deve oping world. He says that approach ca rip the delicate social fabric of develo ing countries, provoking unrest. Instea he says rich countries should lower ta iffs and let the poorest countries kee their barriers mostly in place for now protect jobs and develop domestic i dustries. Rich countries, he says, shou help poor ones build the institutions ar infrastructure they need before they ca open their markets.

Stiglitz' arguments are stiffening th resistance of developing countries to co cessions in the Doha Round of glob trade talks, which are threatening to co lapse. Pascal Lamy, director-general of th World Trade Organization, says Stigli underestimates the benefits that po countries get from trade. But he acknow edges Stiglitz' influence. Says Lam "Many places on this planet would love have him as a speechmaker."

The rap on Stiglitz is that the agen he's pushing has little to do with his N bel prize-winning work. Kenneth Rogo a former chief economist of the Intern tional Monetary Fund, once accus Stiglitz of being out of touch with rea ty—or as he put it, living in "the Gamm Quadrant." Olivier J. Blanchard, a leadi macroeconomist at Massachusetts Ins tute of Technology, once said that Stigli warnings to Eastern European natio about the dangers of privatization we "more often than not catastrophic."

Stiglitz responds that his policy pr scriptions do flow out of his academic r search. The essential insight of inform tion economics is that markets oft misbehave when one party to a transa tion knows more than the other, or wh critical information is hard to get. Sm businesses, for example, often have a ha time getting bank loans. The reaso

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Lenders don't have enough information to distinguish between creditworthy small businesses and those that are more likely to fail.

According to Stiglitz, Adam Smith himself—the patron saint of antigovernment economists—was no doctrinaire believer in markets. "Smith had a very nuanced view," says Stiglitz. "He was very aware of market failures."

A Stiglitz aim: Policies that eliminate the "fertile feeding ground for terrorism"

Stiglitz, 63, imbibed New Deal thinking from his parents while growing up in the steel town of Gary, Ind. His office is furnished with mementos of his travels, including a photo of him looking like Yul Brynner (with hair), resplendent in a gold costume and upturned shoes as he sits on a throne in Thailand. He comes across as rumpled and affable, but he has a streak of combativeness.

Stiglitz resigned from the World Bank in 2000 after clashing with then-Treasury Secretary Lawrence Summers. In 2002 he trashed Treasury and the IMF in *Globalization and Its Discontents*. More than 1 million copies were sold, and the book was translated into 37 languages, from Azeri to Sinhala. Now much of his energy goes into the Initiative for Policy Dialogue, which devises "policy alternatives" for developing countries. In recent weeks, his name has been in headlines in Indonesia, Cuba, Italy, India, and Kyrgyzstan, and he wrote op-eds for papers in Pakistan and Taiwan.

Many American politicians aren't eager to embrace him. Senator Hillary Rodham Clinton's (D-N.Y.) press office failed to respond to repeated calls for comment for this article. But Stiglitz did have an influence on Kerry's campaign, says Furman. Stiglitz says that helping poor countries will be good for rich ones: Americans would pay lower taxes if subsidies to U.S. farmers were eliminated. And more wealth in the developing world will increase demand for U.S. exports while making poor countries less of a "fertile feeding ground for terrorism," he says.

The anger over globalization is widespread. That alone ensures Stiglitz, an eloquent and credentialed critic, of long-lived influence.

A Ton of Prevention

The pros and cons of two drugs that may halve your risk of breast cancer

BY CATHERINE ARNST

HOW MANY TRADE-OFFS would you make to halve your risk of developing breast cancer? That question is more than just a philosophical exercise. Results of a huge, government-run study published on June 21 proved that two drugs, tamoxifen and Evista, can cut risks in half. Other such treatments, known as chemopreventives, are now in the lab.

Cancer prevention is the holy grail of oncology research, and specialists are delighted that they have not one but two drugs that can actually keep breast cancer at bay. But the drug regimen is not an unqualified success. Taking a pill every day for at least five years to lower the odds of developing tumors can cause other sorts of troubles. Sorting out the pros and cons is a complicated task.

Although breast cancer mortality has declined dramatically in recent years, it is still second only to lung cancer as the deadliest cancer for women. An estimated 41,000 U.S. women will die of the disease this year, and 213,000 new cases will be diagnosed. The average American female has a 10% chance of developing breast cancer in her lifetime, and those odds can worsen depending on lifestyle, family history, and estrogen exposure. For some women with certain gene mutations, the risk can run as high as 60% to 80%.

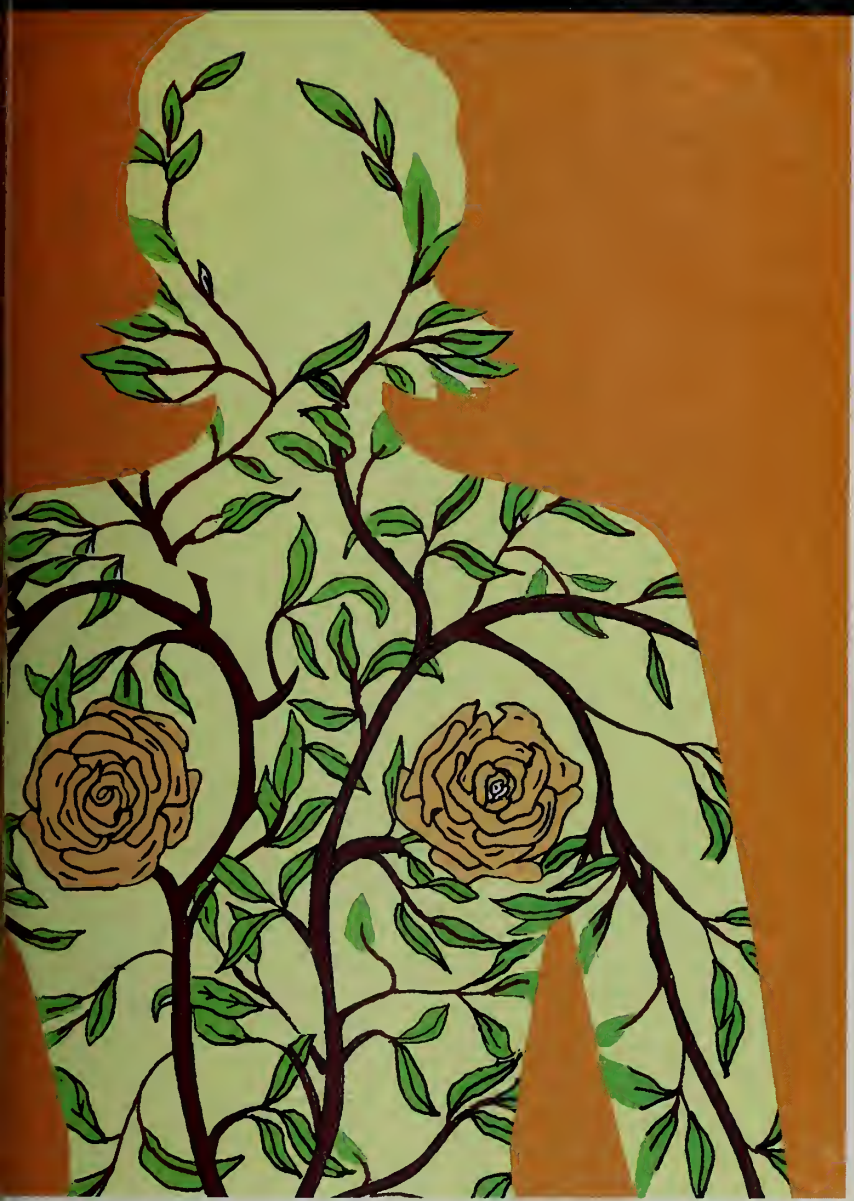
Before worrying about prevention, every woman should figure out how likely she is to develop breast cancer in the first place. Doctors calculate the likelihood with the Gail model, a formula that combines various indicators, including the age of initial menstruation and menopause, the number of pregnancies, whether a close relative has developed breast cancer, and whether any biopsies have revealed abnormal breast cells. The Gail formula estimates both five-year and lifetime risk; a woman with a five-year score of 1.66% or gre is a candidate for chemoprevention.

A high Gail score doesn't doom yo means that your chances are at least 1 17 in 1,000 of developing breast ca over the next five years. A small perc age of breast cancer patients have ar herited form of the disease, however, u

Loading The Dice

Women worried about developing breast cancer have two options for improving their odds

	TAMOXIFEN	EVISTA
PROS	» Long used to treat breast cancer, this drug can also cut the risk of developing the disease by half	» Approved for osteop drug cuts invasive brea risk by half, with less da uterine cancer than tar
CONS	» Slightly raises risk of uterine cancer and blood clots, and can cause vaginal discharge, hot flashes, and leg cramps	» Does not cut risk of noninvasive breast can can cause joint pain, w gain, and vaginal dryne



related to mutations in the two BRCA es associated with the breast. If you test itive for these mutations, your risk ots through the roof, making the ice of chemoprevention an easy one.

EMMA

SLIGHTLY ELEVATED risk leaves nen wrestling with the tamoxifen vs. sta dilemma, if they decide to do any- ıg at all. "This really is an issue each man has to discuss carefully with her tor," says Dr. Cheryl Perkins, senior ical adviser for the Susan G. Komen ast Cancer Foundation in Houston, a ler in breast cancer research. Special- note that neither drug has been shown keep women alive longer, suggesting t they may be arresting cancers that uld have been curable in any case. "Of rse you avoid the stress of cancer," says Elisa Port, a breast cancer specialist at Memorial Sloan-Kettering Cancer Center in New York, but she adds that, with early detection, breast cancer can be treated and even cured with minimal side effects.

Both tamoxifen and Evista block estrogen, a hormone that can promote tumor growth. Tamoxifen, a generic drug long used to treat breast cancer, was approved for prevention in 1998. But few women choose to take it, in part because it slightly increases the risk of ovarian and endometrial cancers, and of life-threatening blood clots in the lungs. Evista, also known by its generic name raloxifene, is an Eli Lilly & Co. drug widely used to prevent osteoporosis in post-menopausal women. It is not yet approved for breast cancer prevention, but the drug was tested against tamoxifen for that purpose by the National Cancer Institute in 20,000 high-risk women over seven years, the largest prevention study ever.

The final results, published in the *Journal of the American Medical Assn.*, showed that both drugs reduced the risk of invasive breast tumors by 50%. Keep in mind that they did not prevent breast cancer altogether; there were 163 cases in the tamoxifen group and 167 in the Evista arm of the study. Without the drugs, specialists would have expected twice as many. Evista slightly elevated the risk of uterine cancers, but less so than tamoxifen. But Evista did not lower the chances of developing early-stage, noninvasive breast cancers found in the milk ducts. These cancers are curable if detected early but can turn deadly if they spread.

SIDE EFFECTS

WOMEN ON THE TWO drugs reported different experiences regarding quality of life. Although most said the side effects were mild, those on tamoxifen more often complained of hot flashes, vaginal bleeding, bladder control problems, and leg cramps, while Evista patients more often suffered from joint pain, pain during sexual intercourse, and vaginal dryness. As for cost, a daily tamoxifen pill runs about $100 per month, and Evista $75.

So, which course to choose? "I would advise that women should start on one drug and then reassess in three months," says Dr. Patricia Ganz of the Jonsson Comprehensive Cancer Center at the University of California at Los Angeles. She would probably start a woman who has not had her uterus removed on raloxifene. "Otherwise, it would depend on what is really important to her."

There are several other agents being studied as breast cancer chemopreventives, but none has proved effective so far. A new class of breast cancer treatments called aromatase inhibitors appear promising, in part because they can prevent cancer from recurring when taken after surgery or radiation. There are several current studies to see if the drugs can prevent breast cancer in the first place, but these will take some time. Cox-2 pain relievers, such as Celebrex, have also shown promise in some studies but can raise the risk of heart disease. "Keep in mind there is no free ride," cautions Port.

Actually, there is one free ride. Several studies have suggested that a healthy body weight and regular exercise not only lower the risk of developing cancer but also improve survival odds in women who do develop the disease. Unfortunately for older women, this natural approach is most effective—and perhaps only effective—if started early in life. A good reason to get our daughters to the gym.

HP recommends Windows XP Professional

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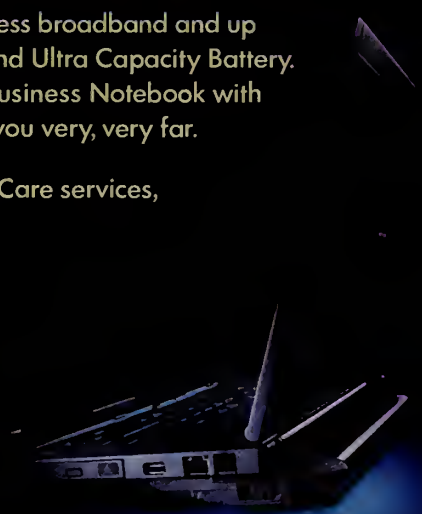

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configuration, loaded applications, features, and power management settings. The maximum capacity of the battery will decrease with time and use
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ITED BY ADAM ASTON

NNOVATIONS

f trans fats and o-sneeze cats

A new study flies in the ce of the longstanding lief that a calorie is a lorie, be it vegetable or imal. Researchers at Wake rest University found that ans fats used to enhance e flavor and texture of many ods are more prone to use weight gain than other pes of fat. Monkeys fed a et containing trans fats had 7.2% gain in body weight, hile monkeys fed the same mber of calories, but with althier monounsaturated s such as olive oil, gained ly 1.8%. What's more, all e extra weight gained by the ans-fat-eating monkeys cumulated in their domens, increasing the k of heart disease.

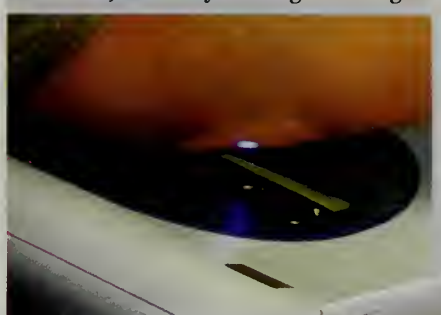
Love felines even though ey set off your allergies? If u have a spare $3,950, plus 95 for shipping, you may able to do something out it. San Diego's Allerca ys it will ship its first poallergenic cats next ring. The first kitties have ready been bred. They are t genetically modified. ther, Allerca developed a st to screen for variations in e gene that controls Fel D1, e allergy-producing protein at cats secrete. It then lectively bred cats with Fel deficiencies until it came with hypoallergenic litters. lerca plans to publish its rk later this year.

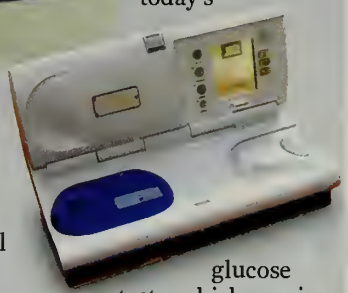
–*Catherine Arnst*

TESTS

USING INFRARED TO SEE IF YOU'RE LIT

A NEW NON-INVASIVE device promises to check blood alcohol levels in 90 seconds, as opposed to 20 minutes for a typical Breathalyzer test. The system (bottom right), which looks like a drug-store blood pressure monitor, works by shining a harmless beam of infrared light on the skin of the forearm. Alcohol in the tissue absorbs light, so the amount that reflects back indicates how much alcohol is present.





Designed by Albuquerque-based TruTouch Technologies, a spin-off of InLight Solutions, the test should go on sale next year, first to law enforcement agencies and later for workplace testing. TruTouch CEO Jim McNally says the test could also work in an "interlock" device in a vehicle, stopping ignition if a driver is drunk.

VeraLight, another InLight spin-off, adapted the same core technology to help diagnose diabetes (left) using fluorescent light instead of infrared. Compared with today's glucose tests, which require eight or more hours of fasting, the VeraLight Scout system is 20% more accurate and offers results in about a minute.

–*Aili McConnon*

ALZHEIMER'S

NEW PILLS FOR ADDLED MINDS

MICE ARE IMPERFECT models for testing treatments for human diseases. Even so, scientists at the University of Toronto are excited by what transpires when they administer a small molecule called scyllo-inositol to mice whose brains are riddled with protein plaques that are a hallmark of Alzheimer's disease. In studies reported in the online edition of *Nature Medicine*, researchers fed the drug to mice implanted with human genes that predispose them to develop a disease resembling Alzheimer's.

Not only did the plaques vanish after the treatment, but cognitive functions also returned, and the animals lived longer than untreated mice with the same condition. Transition Therapeutics, a public Canadian company, has initiated early-stage trials in human subjects.

–*Neil Gross*

FUEL

FROM CORN TO ETHANOL IN A JIFFY

POWERFUL BLASTS of sound can help squeeze energy out of corn kernels more quickly than today's strictly mechanical approach, say Iowa State University researchers. This suggests that gasoline-replacing ethanol could be eked out of each bushel of corn more rapidly, thus raising the output at an ethanol plant.

In tests, mashed corn kernels were passed through a doughnut-shaped device that emits high-energy ultrasonic sound waves. At 20 kilohertz, the pulses are too high for most humans to hear, but they are powerful enough to cause countless bubbles to form in the mash. These pop and release tiny shock waves that break down the corn particles to 1/100th their original size. The smaller the bits, the more of the starches can be made into sugars, to be fermented into ethanol, says Samir Khanal, assistant professor of environmental engineering.

The sound treatment yields sugar at a rate that's 30%-40% faster than today's purely mechanical method. But much of the sugar is of a more complex chemical makeup, which can slow the rate at which it is converted into ethanol, adds Khanal's colleague David Grewell. The team's next step is to find out just how much the new process affects the final ethanol yield.

Death of a Pushy Salesman

More outfits are using "empathy training" to help sales reps get into customers' heads

BY CLIFF EDWARDS

MIKE DIONNE EPITomized the hotshot sales rep of the heady late-'90s info tech boom. A master of the full frontal assault, Dionne, who works for San Jose (Calif.) chipmaker Altera Corp., juggled 25 accounts, winning customers on complex features that only an engineer could love. But when the bubble burst in 2000, Dionne's sales dried up fast, and no amount of wheedling could persuade many of his customers to meet with him. He talked a lot but listened for the wrong things. The market had changed, but Dionne hadn't.

Six years later, he handles only seven accounts and often takes four times as long to close a deal. He listens more, too. In early June, for example, Dionne met with an exec at a Massachusetts-based medical firm for the first time. He reiterated what he had said on the phone: Altera was looking at how it should invest in the medical field. For 90 minutes, Dionne sat quietly as the potential customer described the technology he planned to buy and the obstacles he expected. Dionne never said Altera wanted to sell him chips. "You could tell [the IT exec] was jazzed," says Dionne. "He was comfortable, leaning back in his chair and talking freely."

That meeting did n close with a sale, but Alte Chief Executive John Daane couldn't be happ with Dionne's approac The transformation is actly what Daane hoped see from a three-year eff to create a more empath ic workforce. Since 20 Daane has spent nearly $ million on training, usi self-proclaimed "empat consultants" to help sales force identify w customers' situations, fe ings, and motives.

This is no one-d workshop: Altera's 1,1 salespeople take f weeks off in their first y of training instead of sc ing up new business. it's worth it. "We're tryi to understand and devel better customer relatic ships," Daane says. "We still in the very early nings of using custon empathy to get there."

Consultants to com nies as far afield as Goo Abbott Laboratories, and Agere Syste increasingly are using the word "em thy" as an easier-to-understand path ward the oft-repeated, but rarely realiz goal of customer intimacy. It's especia hard in engineering-heavy cultures Altera's, where the language of spe and feeds has traditionally reigned o customers' real needs.

CULTURE SHOCK

FOR MANY OF ALTERA'S folks, the tra ing, which included personality tests a exercises that put them in their c tomers' shoes, registered somewhere tween science and superstition. It was foreign to many that, according to Daa about 10% of his sales team quit rat than continue with the training. "Pec don't really want to see life exactly as customer sees it. They just want to stuff," says Rory Clark, a consultant v works with Altera on empathy trainin

But is there an ROI on empathy? If c tomers such as Tony Pirih, vice-presid of Motorola Corp.'s Wireless Broadb Div., are representative, the answer is Pirih is so pleased with Altera's ser that he has recommended the chipma to other Motorola division heads. Rec ly his engineers were struggling to f bug in a new broadband radio prod

ısed Altera's chips. When
ı heard of the trouble, it
ɔver its experts, unsolicit-
ırns out the problem was
Altera's chip, and the
any patched it up within a
'Empathy? Wow, what a
word," Pirih says, "but
ıve to agree they're sym-
tic and sensitive to the is-
we have."
ane believes empathy
ng goes straight to Al-
bottom line. In 2005, Al-
was one of the fastest-
ing chip companies in
n Valley, with sales that
ed 11%, to $1.1 billion.
a one-trick pony that
ed to the telecom sector, it
ared destined for destruction after
tumbled 65% in 2001. But now its
, which customers can continually
gram, have become an alternative to
m designs for thousands of cus-
rs in computing, car manufacturing,
onsumer electronics.
th product life cycles shortening in
industries to as little as a few
hs, many companies don't have the
y of thinking about technology 5 to
ars out and are asking suppliers to
hem anticipate their needs. That re-
s Altera to think about market dy-
es, customer strategies, and technol-
oadblocks. Since one person can't do
f that, companies must marshal
s of both different temperaments
kills.
at's where empathy training comes
uided by the credo that you must first
yourself to know others, Altera's
oyees first had to take the Myers-
gs Type Indicator. A common per-
lity test, it helped Altera form the
teams.
en consultants took the sales force

OF ONE MIND Training to listen better to customers at Altera

through a series of exercises to help them see things from others' perspectives. To show how different people's minds work, salespeople were shown pictures, such as one of a yellow rose, and asked to list every thought it triggered. To make a similar point, a sales manager was asked to describe what it feels like to fire someone. Some in the room reacted objectively, noting the need to punish poor performance, while others were emotional, remarking on the impact on morale.

Another method, "the hot seat," asks salespeople to imagine stepping up behind a person and looking at the world through his or her eyes. An empathy trainer playing the role of the customer gives the salesperson 10 minutes to ask as many questions as he can to "uncover" what problems the customer faces.

Such exercises can be irksome for high-tech types who might not be intimate with their softer sides. Bill Brown, for example, who was known for his aggressive sales tactics, found the hot seat method frustrating. After 40 questions, he had barely dented the surface. Clark, the consultant, suggested Brown talked too much and hardly listened for cues. Brown first called it hogwash, but later he got on board.

Beyond sales force training, Altera is creating more ways for its people to be empathetic. At its weekly customer advisory councils, the company flies in 15 to 20 customers, who are surprised to be asked to make presentations on their own strategies and future needs. Customers, unaware that Daane assigns executives as "buddies" to key accounts, say they have been happily surprised to find top Altera management attending. "It's like the difference between Nordstrom's and Macy's," says Brian Arkin Sr., director of hardware engineering at Credence Systems Corp., which tests wireless systems for telecoms.

FROWNS AND FIDGETS

FOR A TIME, IT looked like Altera would not win Credence's business. Sales rep Brown spent four years beating on Credence's door before receiving empathy training. Using techniques he learned about body language, he guessed from their executives' frowns and rocking back and forth that his big-picture pitches were falling on deaf ears. When he used more detailed timetables, Credence signed up. "You forget that not all people think exactly like you do, and the training absolutely helps with that," Brown says.

With Daane committed to years more of empathy training, Altera's sales force won't soon forget the human factor. The once-skeptical Brown can't wait for more. He even tried "uncovering" the goals of his family before deciding on a vacation to Disneyland. "This stuff has so much applicability to your entire life," he says. "As soon as you see it working, the idea of touchy-feely is out the door."

PLAYBOOK: BEST-PRACTICE IDEAS

p Close & **Personal**

Altera hired "empathy" coaches to help its people see things from their customers' point of view. How to make your team more empathetic:

ORK FROM THE SIDE OUT

ployees can't truly know their tomers unless they know nselves first. Consider 360-ree reviews and personality s. Then organize teams around rse temperaments, so they can predict customer needs.

BE SEEN AND NOT HEARD

Consultants describe due diligence and listening as "uncovering." In initial meetings with customers, Altera salespeople spend most of the time saying nothing. Rather than promoting products, they listen for customer problems.

WATCH FOR SUBTLE CUES

If customers are leaning back in their seats, they're relaxed and comfortable; looking at their watch spells trouble. Listen for whether people want facts and figures or "big picture" information and tailor presentations to fit.

NURTURE CUSTOMER INTIMACY

Creating customer empathy is no one-time affair. Rotate employees annually through exercises such as role-playing and conflict resolution. Assign top managers as "buddies" to key executives from customer accounts.

When Dad Bets On an Archrival

LCA regroups after its CEO disclosed a hefty investment in another vision center

BY ARLENE WEINTRAUB

BIG DRAMAS AND LITTLE companies can make for a volatile mix. Consider the recent travails of LCA-Vision Inc., which operates 55 LasikPlus vision correction surgery centers. In March, LCA founder and CEO Dr. Stephen N. Joffe disclosed that earlier this year he invested $27 million in shares of LCA's archrival, TLC Vision Corp. Soon after, he stepped down and the board replaced him on an interim basis with his son, Craig, LCA's chief operating officer. Stephen did not respond to requests for comment, but a Securities & Exchange Commission filing says he deemed TLC "an attractive investment opportunity." Responds Craig: "Our relationship is strained." LCA's shares fell 25%, to 42, during the monthlong fracas.

The younger Joffe is making progress reassuring investors that his dad's departure is merely a distraction and not a sign of trouble at the company. Just two weeks after taking over, Joffe announced that LCA's 2005 revenues soared 51% over 2004, to $192.4 million, while pretax income doubled, to $52.8 million. With nearsighted folks eager to undergo the short surgery that could allow them to shed their glasses and contact lenses, LCA saw its average annual earnings increase 108.7% a year during the three years ending in May, on sales that rose 47% annually. That earned it the No. 9 spot on *BusinessWeek*'s Hot Growth ranking.

HOT GROWTH COMPANIES

Since its founding in 1985, Cincinnati-based LCA has adopted a few key selling points that set it apart from the independent surgeons who dominate the laser correction market. LCA charges an average of $1,375 per eye—about 35% less than the market average. By employing its own physicians and offering them benefits and performance-based compensation, the company attracts top-flight surgeons.

SON CRAIG JOFFE describes his relationship with his father as "strained"

LCA has also mastered the art of targeted marketing. It has relationships with several vision-care insurance companies, which offer members discounts on LasikPlus surgery. Joffe opens new stores in markets where competing ophthalmologists have spent heavily on ads promoting Lasik. "We want customers who have already been primed," says Joffe, 33, as he tours a recently opened LasikPlus in Paramus, N.J. As in many LasikPlus stores, the office's surgical suite has glass walls, so prospective patients can watch others undergo the s ple procedure (though some custor choose to draw the shades).

Word-of-mouth marketing has be boon for LCA. Shawn Anderson, works at UBS, decided to have his fixed at LasikPlus in Cincinnati afte wife raved about the surgery she there. Anderson, an avid hunter archer, had been wearing glasses or tact lenses since the fifth grade. "M sion is better than it was when I had tacts," says Anderson, 37.

RUNNING ROOM

ANALYSTS HAVE DISMISSED the se Joffe's stock purchase as a case of judgment, but they say that more ta ble threats loom on horizon. First is the ry that broad econc pressures such as gas prices and infla may cause consume put off elective surge Maxim Group ana Anthony Vendetti say sees signs that LC boosting its spendin marketing, possibly counteract a drop in tient volume. Such p sures may have dr LCA's stock down since June 1, to 47.60 economic condit worsen, it will be a cern," Vendetti s Meanwhile, rival TLC sion is expanding a cl of value-priced vi correction centers.

Investors will be l ing to LCA's quart earnings release in for reassurance that company can through the econc dip. Joffe, who is one of the candidate the top job at LCA, believes that Lasik plenty of room to run, estimating fewer than 10% of the 60 million pe eligible for laser vision correction had it done so far. And Joffe predicts procedure will draw patients who only slightly nearsighted, as he was fore he went under the laser five y ago. "I didn't have Coke-bottle glas but they were an inconvenience anyw he says. As for those inconvenient nomic pressures, he says, "Given 25% of Americans are myopic, even if cretionary spending dampens, we bel our growth will continue."

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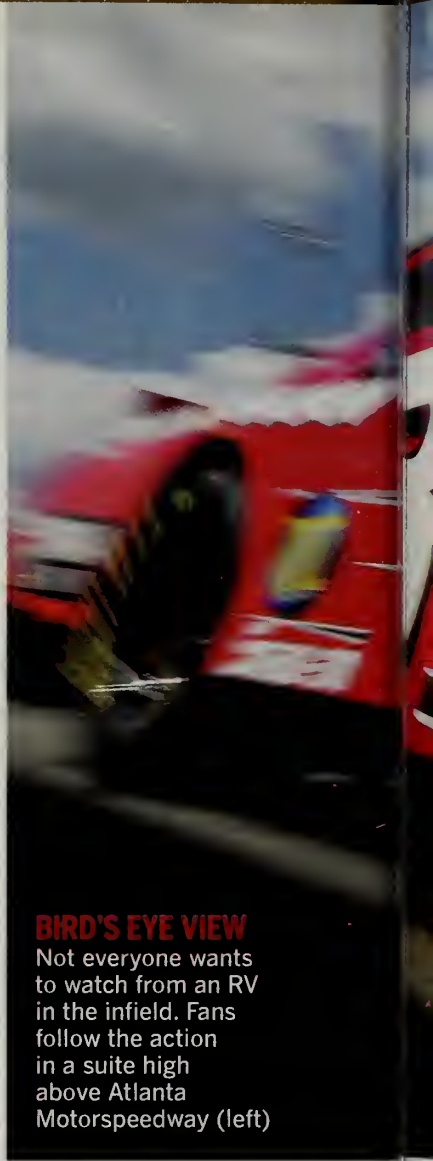
NASCAR For Newbies

Fans can now sit in luxury boxes and eat sushi. But for a new convert, the thrill is on the track. **BY ANDREW PARK**



BIRD'S EYE VIEW Not everyone wants to watch from an RV in the infield. Fans follow the action in a suite high above Atlanta Motorspeedway (left)

I'M STANDING BEHIND A short chain-link fence at Lowe's Motor Speedway in Concord, N.C., when my friend Paul yells in my ear. "All five senses!" he shouts. "What?" I reply, barely able to hear him over the intermittent roar of stock cars passing in front of us. "It's the only sport that arouses all five senses!" he yells, and he's right. I can't escape the sight of the cars' shimmering paint schemes, the deafening sounds of their engines, the stink of melting tires, or the rattling of the grandstands. And taste? Cold beer from a can. This is NASCAR, after all.

Before that muggy day in May, I had somehow missed out on one of the biggest sports phenomena of the past decade, despite spending most of my life in the Carolinas, NASCAR's epicenter. Consider this: The number of people who spend six or more hours a week following the sport has grown almost 20% in the last five years, to 75 million, according to market researcher Ipsos Insight.

GOING UPSCALE

AS MANY OF THOSE fans know, NASCAR long ago outgrew its Southern, working-class roots. The 40-week schedule, which runs February through November, includes weekends in Chicago and Las Vegas, and could one day include New York, Seattle, and Denver. Upscale brands such as Sony, Gulfstream, and watchmaker Tissot have signed on as sponsors, a developers are furiously adding tracks luxury condos, private clubs, and cor rate suites. For example, Phoenix In national Raceway just opened a c lounge above the track's first turn wh fans can nibble sushi and sip wine mixed drinks. A weekend pass to lounge during November's Checker A Parts 500 will run $2,400, but the ra way is only selling 100 such tickets.

Even celebrity chefs are getting i the act: Food Network's Mario Batali penned a cookbook for race-day t gaters; Wolfgang Puck will open a caf the track in Fontana, Calif., in Septem "The image of [NASCAR as] the Bu sport is not true," says Larry DeGari sports-marketing expert whose clients clude United Parcel Service, Pepsi and Bank of America.

A day at the track has become a co ed perk for executives whose compa spend millions to sponsor NASCAR—: their clients. Debbie Acocella, a custo business manager for Kellogg's in N York, got her first taste of the sport in J

she hosted two supermarket buyers heir families at the Neighborhood lence 400 in Dover, Del. Their Sun- ncluded a catered breakfast, lunch, nack in the relative quiet of the com- s suite, a tour of the pits, and a pre- isit from Kyle Busch, who drives the gg's car. The group watched the start race up close before turning to the "You can see why we have a car," lla says. "I finally understand it."

BY SIDE AT 200 MPH

TICIPATED MY first race for weeks, ering whether I'd be blown away or to tears. More experienced friends sted I start with the NASCAR Nextel ar Challenge, a 90-lap evening t that's shorter to sit through than and sometimes more exciting. The enge doesn't count in the standings, offers a $1 million prize.

ce the 20 cars' engines started to le, the only thing on my mind was . For a few preliminary laps, the cars led together, moving at a madden- slow pace. But in an instant, that jostling mosh pit turned into a screaming double-file line accelerating toward 200 miles per hour. That moment might have been the most exhilarating few seconds of sports I've ever experienced. One reason why NASCAR fans love to see wrecks is that they slow everything back down, bunch up the field, and set the stage for another collective burst of speed.

Understanding the finer points of racing is more difficult. The rules can vary from track to track. With only three carmakers (Dodge, Ford, and Chevy) and one kind of tire (Goodyear), the competition in the top division, the Nextel Cup Series, often comes down to tuning, pit stops, and track tactics. A winning driver might jump out to an early lead because his car is faster than the field and his crew executes well. Other times, a winner might have to steer his way out of an hours-long scrum on the very last lap. Either way, the drivers are making life-or-death decisions as they try to control their hot, hulking vehicles.

Even more impressive is the passion the fans have for the drivers in this age of prima donna athletes. One explanation: As independent contractors, drivers are kept on a short leash by sponsors and team owners, and most financial disputes and extracurricular antics are kept out of the public eye. Fans also get a more intimate view of drivers than they do of other sports heroes. The committed fans camp in the infield near the pits and garages, and for $35 anyone can rent a scanner that allows them to listen to the unfiltered chatter on team radios.

Are the fans rowdier than other sports devotees? Most tracks still allow you to bring coolers stocked with beer, and in certain sections, throwing chicken bones and empty cans is a hallowed tradition. But not far away, hospitality tents teem with corporate types in golf shirts and khakis. For the past few weeks, I've found myself scanning the sports section for racing news and following the points race, which determines who will vie for the NASCAR Championship this fall. Am I going to rush out and buy my favorite driver's flag? Nah. But I'll go back.

Don't Burn, Baby, Don't Burn

New sunscreens, monitors, and high-SPF clothes can help ward off harmful rays. BY LARRY ARMSTRONG

EVER WONDER ABOUT that sought-after sun-kissed glow? It's nature's way of trying to protect your skin from the evils of ultraviolet rays. But there are much more effective sun shields than your own skin. You can now find a wide array of protective clothing. UV sensors can warn you when you've had enough exposure. There are even new nonprescription pills that claim to protect you from sunburn and its damaging effects.

SPLASH-PROOF This Oregon Scientific sensor gauges how long you can stay in the sun

Sunscreens are usually your first line of defense. Johnson & Johnson has come up with a new formulation that promises to be a better barrier against ultraviolet A rays, which cause premature aging and can contribute to skin cancer. (The sun protection factor, or SPF, measures only protection against UVB light, which causes sunburns and cancer. It is a measure of how long protection lasts.)

Used in its Neutrogena and Aveeno sunscreens, J&J's breakthrough stabilizes a UVA blocking agent, avobenzone (or Parsol 1789), which normally breaks down after an hour or two in the sun. Neutrogena calls the resulting blocker Helioplex; Aveeno refers to it as Active Photobarrier Complex. The new sunscreens come in SPFs of 30 to 55, and they're good for up to four or five hours. J&J's formulation is an attempt to find a UVA shield as effective as Mexoryl and Tinosorb, which are in European sunscreens but aren't yet approved for sale in the U.S. Widely available over the Web, Mexoryl and Tinosorb are in such brands as Anthelios, Ombrelle, Vichy, Avene, and Bioderma Photoderm. Other UVA blockers you can buy in the U.S. are zinc oxide and titanium dioxide.

BLOCKS UVA RAYS, TOO Some of Johnson & Johnson's Neutrogena and Aveeno brand sunscreens use a new formula

Even the best sunscreens wear off, so reapply them every couple of hours, especially if you've been sweating or swimming. And know when you've had enough. A good way to keep track of your cumulative exposure is to get one of the products that react to UV light. SunSignals self-adhesive patches, $5 a pack of 18, gradually change color from bright orange when exposed to UV rays, warning you to reapply your sunscreen or go inside.

SPF 50+ Coolibar.com sells a sports hat for kids, $15.95

A better bet is an electronic UV monitor, which costs about $25 or $30. Crosse Technology makes one that looks like a sports watch, or there are styles you can wear around your neck from Chaney Instrument and Oregon Scientific. Program them with your skin type, from fair to dark, and the SPF of your sunscreen. They calculate the strength of the day's UV rays and use that to count down the time you can stay outside safely. Oregon Scientific's model is splash-proof and includes a digital thermometer. It's $20 at Target.

WASH-IN PROTECTION

IF EVEN A LITTLE SUN is too much, cover up. A white T-shirt has an SPF rating of only 5, and less when it's wet. Darker colors and heavier fabrics are better, though they're not the first thing you reach for on a sunny day. Companies such as Coolibar, Sun Precautions, and NoZone make colorful lightweight hats and clothing with SPFs as high as 50. Do-it-yourselfers can approximate the effect with SunGuard, a laundry additive from the makers of Rit Dye. A $2 box will give that ordinary T-shirt an SPF of 30, and the protection lasts about 20 washings.

Dietary supplements such as Sunsafe from Pure Pharmaceuticals and Heliocare from IVAX claim to protect you from the sun for about a dollar a day, but be warned: Dermatologists say they won't hurt, but they're no substitute for a good sunscreen and a hat.

BusinessWeek online For a slide show on more sun protection products, go to businessweek.com/extras.

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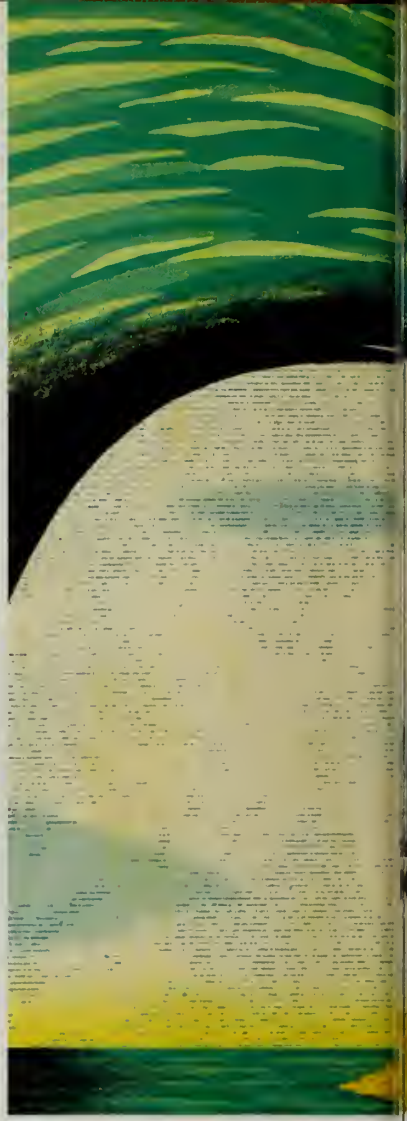
How to Fight the Undertow

We asked three top research firms for stock picks that are likely to keep portfolios afloat. **BY TODDI GUTNER**



DURING A RUNAWAY BULL MARKET, investors can do well buying companies with hazy business models and questionable financials. But when the market gets rough, as it has the past six weeks, quality counts. Since the Dow Jones industrial average's May 10 high, and in two prior pullbacks in 2001 and 2002, companies identified as low risk by three major stock research firms fared better than the market averages and far, far better—as much as 35 percentage points—than the riskiest sorts (table). ¶ The lesson? In these volatile markets, trade up to low-risk, high-quality stocks with strong fundamentals and a relatively cheap price. They won't defy gravity: If market forces are pushing stocks down, they're going down, too. But they could lead the way back when the market regains its footing.

Which stocks fit the bill? We asked independent research firms Morningstar, Standard & Poor's (which, like *BusinessWeek*, is a unit of The McGraw-Hill Companies), and Value Line to name the companies in their safest category that have the most potential for upward movement (table). Here's how they identify them:

MORNINGSTAR A profitable outfit may be a good investment unless it is likel continue to rack up riches. It neec "wide moat" around its business strong competitive advantage makes it difficult if not impossible fo vals to encroach.

Morningstar analysts say that W Wrigley Jr., a current pick, is a w moat company. (The firm classifies c panies as having a wide moat, a nar moat, or no moat at all.) The chew gum giant, which controls 60% of

Less Risk, Fewer Losses

Among other things, stock-rating services assess the riskiness of a stock. Here's how their choices performed in recent market corrections.

COMPANY		STOCK MARKET DECLINES 5/25/01 TO 9/21/01	3/15/02 TO 10/11/02	5/10/06 TO 6/13/0
Morningstar*	Least Risky	-13.4%	-15.2%	-3.9
	Most Risky	-36.8	-50.3	-14.7
S&P	Least Risky	-20.9	-19.1	-6.1
	Most Risky	-41.1	-56	-10.7
Value Line	Least Risky	-10.5	-16.3	-4.9
	Most Risky	-35.2	-52.2	-18.6
Dow Jones Industrials		-25.2	-26	-8
Standard & Poor's 500		-24.4	-28.3	-7.3

*Ratings service began 8/6/01 **Data:** Morningstar, Standard & Poor's, Val

and 35% of the global ket, benefits from a low- worldwide manufactur- and distribution system. nomies of scale allow it to d generously on market- and advertising to main- its leading position and ain profitability over the term.

orningstar then looks at mpany's "business risk," oprietary analysis that is rated from data gleaned from the nce sheet and income statement. o get to the stocks recommended in table, Morningstar applied wide- t and below-average business-risk ifications to its 1,768-stock universe then overlayed "strong buy" status, e-star analyst recommendation. An- s give five stars to companies that selling at a big discount to the value xpected cash flows and that are pre- d to reach their target prices in e to five years. Morningstar's online cription costs $135 per year, or 95 a month (morningstar.com; 608-9570).

They won't defy gravity, but quality stocks usually lead in a recovery

STANDARD & POOR'S When you think of a high-quality company, names that usually come to mind are the likes of Citigroup, Johnson & Johnson, and PepsiCo. It just so happens that these outfits get high marks for quality from S&P. "[They] tend to be less vulnerable to increasing interest rates and slowdowns in earnings growth," says Massimo Santicchia, director of portfolio management and strategy for S&P's Portfolio Advisors. The system rates 1,070 stocks from A+ to D on their earnings and dividend growth and stability over the past 10 years. Everything above A- is considered high quality; a grade below B+ puts the stock in the low-quality camp. If the company doesn't pay a dividend, its ranking is capped at B+.

But an A+ alone doesn't merit a buy recommendation. S&P's choices must also get a 5-star (strong buy) rating from an analyst. The Stock Appreciation Ranking System (STARS) rates stocks according to an analyst's forecast of share-price behavior over the next year.

You can buy S&P reports at outlook.standardandpoors.com (800 852-1641) for $35 each. Subscriptions to Outlook Online run $199 a year.

VALUE LINE Unlike Morningstar and S&P, Value Line uses purely quantitative statistics to pick stocks. The system looks at stock price stability over the past five years and at financial strength to create a safety ranking. This ranking, which ranges from 1 (safest) to 5 (riskiest), measures the risk of a stock relative to the 1,700 others in Value Line's universe.

Companies such as Wal-Mart Stores, Medtronic, and Goldman Sachs passed the safety test with rankings of 1. To make the ranking, they also must have strong expected price performance relative to the rest of the Value Line universe during the next 6 to 12 months. This second metric, called timeliness, ranges from 1 (which means that it's one of 100 stocks that Value Line expects to outperform the lower-ranked stocks in its universe) to 5 and is based on 10 years of earnings data. Stocks highlighted in the table have a safety rank of 1 and a timeliness rank of 2 or better.

Value Line charges $598 a year for its weekly print publications, which includes online access. It's $538 for the online version alone (valueline.com; 800 833-0046).

Stocks for a Skittish Market

Raters are now recommending these stocks for their high-quality, low-risk attributes.

COMPANY SYMBOL	VALUE LINE	S&P	MORNINGSTAR
Anheuser-Busch BUD	●		
Automatic Data Processing ADP		●	
Berkshire Hathaway BRKA	●		●
Capital One Financial COF		●	
Carlisle Cos. CSL		●	
Citigroup C		●	
Colgate-Palmolive CL		●	
Exxon Mobil XOM	●		
Fasental FAST	●		
GlaxoSmithkline GSK			●
Goldman Sachs GS			●
Home Depot HD		●	
Illinois Tool Works ITW			●
Imperial Oil IMO			●
Johnson & Johnson JNJ	●	●	
Lockheed Martin LMT			●
Medtronic MDT	●		●
Microsoft MSFT	●		
Novartis NVS	●		●
Occidental Petroleum OXY			●
PepsiCo PEP		●	
Royal Dutch Shell 'A' RDS-A			●
SunTrust Banks STI		●	
United Parcel Service UPS			●
Wal-Mart Stores WMT		●	●
Walgreen WAG	●		
Wm. Wrigley Jr. WWY	●	●	

BusinessWeek weekend For more "low-risk" stocks, watch *BusinessWeek Weekend*. Check your local listings or go to businessweekweekend.com

EDITED BY
MONICA GAGNIER

TAX BREAKS

THE IRS AND HAPPY CAMPERS

DAY CAMP ISN'T just about saving your kids from summer boredom: It can also save you in taxes. New IRS regulations expand the scope of summertime dependent-care credits for children under 13. Part-time employees can claim credit for tuition on their off days, as long as the camp charges by the week or longer. In the past, part-timers were eligible for the credit only on work days. Also, although school expenses usually don't qualify, you can claim the cost of an educational camp, such as one that specializes in computers. Yearly caps are $3,000 per child, up to $6,000 per family, and the credit ranges from 20% to 35% of expenses, depending on income. The new rules also apply if you pay for a camp in pretax dollars through a flexible spending account. *–Greg Hafkin*

RETIREMENT

How Do You Rate?

DO YOU HAVE A GOLDEN nest egg or a merely copper one? *BusinessWeek* got a sneak peek at a new online calculator from A.G. Edwards that lets you figure out how well you are building wealth vs. the rest of the U.S. public (nesteggscore.com). Americans have an average score of 631, a strong "fair" rating based on a system that's similar to scores used by the nation's major credit bureaus. (A 549 or lower is poor, while a 750 and up is considered excellent.) "A fair score is a little bit better than you might expect, considering the negative savings rate," says Sophie Beckmann, an A.G. Edwards financial planning specialist.

That's because the scoring system goes beyond the personal savings rate, which measures what Americans make and spend, and factors in housing and investment values, participation in retirement plans, and cost-of-living data. Thanks to rising home values, low interest rates, and a resilient stock market, nest eggs are in decent shape, Beckmann says.

The national Nest Egg Score is compiled from a recent Harris Interactive survey of more than 2,000 U.S. adults. Figuring out your own score takes just a few minutes. You'll need to answer 14 questions, including your household net worth, years to retirement, and whether you plan to save or invest this year. *–Lauren Young*

AROUND THE WORLD IN ETFs

RYDEX INVESTMENTS has six new ways to profit from a falling dollar. By the end of June, the Rockville (Md.) firm plans to launch six more currency-based ETFs to supplement its six-month-old, $700 million euro ETF. The new ones will each track the Australian dollar, British pound, Canadian dollar, Mexican peso, Swedish krona, and Swiss franc. Each ETF will represent either 100 or 1,000 units of the currency, pay a currency-specific yield, and have a 0.40% expense ratio. *–Adrienne Carter*

RYDEX'S NEW CURRENCY ETFs

CURRENCY	SYMBOL
British Pound	FXB
Canadian Dollar	FXC
Mexican Peso	FXM
Swiss Franc	FXF
Swedish Krona	FXS
Australian Dollar	FXA

Data: Rydex Investments

COLLEGE LOANS

YOU BETTER SHOP AROUND

WITH A RATE HIKE of almost 2% for federal college loans looming on July 1, borrowers trying to refinance have gotten some last-minute flexibility. On June 15, President Bush signed a measure allowing students and parents to consolidate their loans with any lender to lock in one fixed rate. No longer are they required to use the lender that already holds their loans. Before higher rates kick in, shop around for the best deal by checking sites such as consolidationcomparison.com. *–Danna C*

Business Performance on an entirely new scale. Consistent, reliable reporting is helping adidas predict the future. Now sales managers can quickly gauge market trends and turn on a dime. At adidas, the world's only integrated business intelligence platform has earned its stripes.

Business Objects™

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BY GENE G. MARCIAL

LOWE'S: THE STOCK GOT HAMMERED, BUT IT'S STILL ROCK-SOLID.

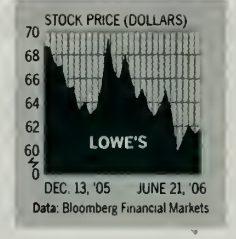
THE PRESSURE IS OFF AT PACKAGING POWERHOUSE SEALED AIR.

ADVANCED LIFE SCIENCES IS TESTING A PNEUMONIA TREATMENT.

Lowe's Is Not Riding High

LOWE'S (LOW) HAS ALWAYS BEEN No. 2 to Home Depot, but it is tops on Wall Street. "Lowe's is Home Depot with good management and without the controversy" (such as the one sparked by Depot CEO Robert Nardelli's $37.9 million 2005 pay packet), says Gabelli Asset Management's Larry Haverty. Ivan Fenseth of Matrix, who rates Lowe's a "strong buy," notes it has stolen market share from Home Depot. He says some customers drive past Home Depot to shop at Lowe's. Like other housing-related stocks, it has been hammered lately, down from 69 in December to 61.81 on June 21. But the drop is "a buying opportunity," says Armando Lopez of Morgan Stanley, who rates Lowe's "overweight." Lowe's isn't saddled with corporate governance issues, which have turned some investors off Home Depot. What's more it has solid fundamentals, says David Clark of Piedmont Select Value Fund, which owns shares. Based on its return on equity (ROE), valuation, and earnings growth, Lowe's is a "compelling long-term buy," he says. That's because ROE, which averaged 16% a year over the past decade, has edged up to 18%. And he sees earnings rising to 19% in 2006, up from an average of 15% over the past 10 years. Clark expects Lowe's to hit 100 in a year. Another bull, Donald Trott of Jefferies, sees earnings of $4.88 a share in fiscal 2007 ending Jan. 30 vs. 2006's $4.21.

AFTER A SLIDE DOWNSTAIRS



Sealed Air: Some of the Bubbles Got Popped

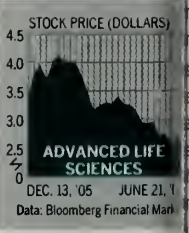
PROTECTIVE PACKAGING SPECIALIST Sealed Air (SEE) has a long history of innovation. Now, a slew of new products, including an inflatable Bubble Wrap called NewAir I.B., should boost what have been flattish operating margins. Ghansham Panjabi of Wachovia Securities, who rates the stock "outperform," says the inventor of Bubble Wrap (it also makes Jiffy protective mailers and Cryovac food packaging) has entered new fields. It has gone into laundry products, and in Europe it has launched shrink wrap. But Sealed Air's stock has been under pressure since April, when it posted first-quarter results below some analysts' forecasts. It fell from 59 to 51.53 now. Even so, Panjabi expects earnings to jump to $3.35 a share in 2006—higher than analysts' consensus estimate of $3.07—up from $2.70 in 2005, lifted by new products and stabilizing raw material costs. Stewart Scharf of Standard & Poor's rates the stock a "buy" based on "favorable earnings prospects" aided by projected increased unit sales, higher prices, and lower raw material costs. His price target for the stock: 67.

LOOKING DEFLATED

Don't Sneeze at Advanced Life Sciences

WHY ARE George Soros, Morgan Stanley, and T. Rowe Price all putting money into tiny Advanc Life Sciences (ADLS)? One reason: Advanced has licensed an oral antibiotic called Cethromycin from Abbot Labs. Designed for respiratory infections, especially so-called community acquired pneumonia, it's a "best-in-cla antibiotic [for] the $14 billion worldwide outpatient market," says Matthew Osborne of Lazard Capital Market which has done banking for Advanced. He rates the stock now at 2.40, a "buy," with a 12-month target of 5. Phase 3 trials of Cethromycin, now under way among 1,000 patients in the U.S., Latin America, and Africa, are to be completed by yearend. Advanced plans to file a new drug application in 2007's first quarter. Cethromycin shows higher potency than Sanofi-Aventis' Ketek, the first ketolide antibiotic, says Osborne. Advanced intends to team up with a major drugmaker for a launch in 2008. Andrew McDonald of ThinkEquity Partners, which has d banking for Advanced, also rates it a "buy." He sees it in t black in 2009, with earnings of 3¢ a share on sales of $78 million and of 50¢ in 2009 on $121 million. In 2005, it los $6.4 million, or 49¢ a share.

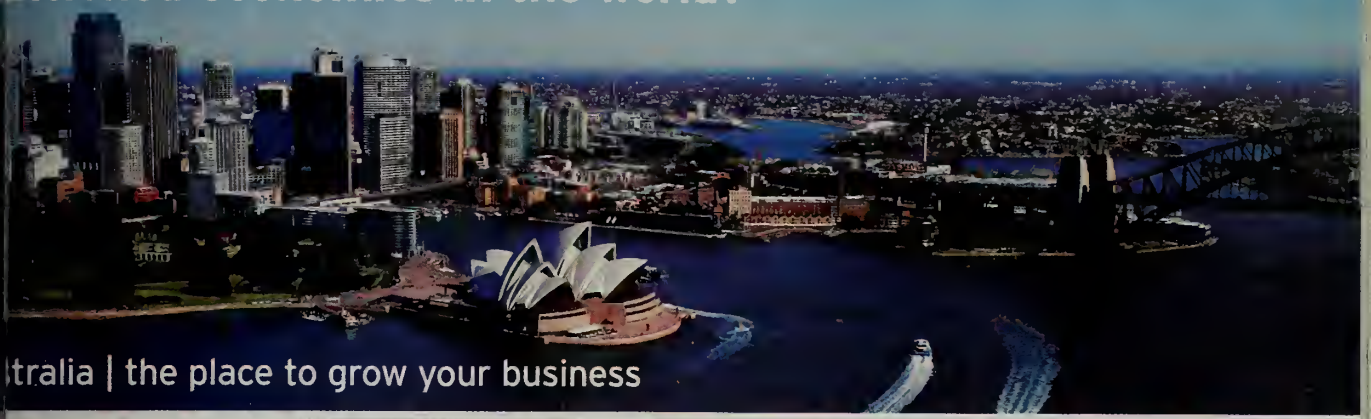
SET FOR A WONDER DRUG



BusinessWeek online Gene Marcial's Inside Wall Street is posted a businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

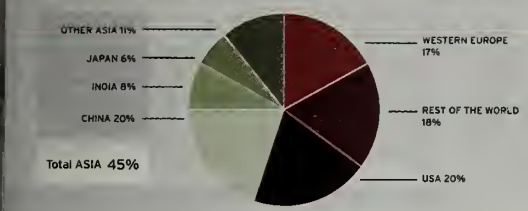
Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor the firms hold positions in the stocks under discussion. Similarly, they have no investme banking or other financial relationships with them.

es your strategy to target more than 45% of global GDP[1] lude one of the most resilient[2], skilled and strategically sitioned economies in the world?



tralia | the place to grow your business

HARE OF WORLD GDP[1] IN 2015



sia-Pacific region is now the engine room of world economic h and has strong prospects for continued growth well into the . By 2015 it is forecast that Asia's economies will account for r cent of global GDP (PPP*)[1], significantly more than the United s and Europe combined. It therefore makes good business sense lude an Asia-Pacific based business in your growth strategy.

tralia–the world's most resilient economy[2]–is now in its 15th year of uous growth and provides global companies with a solid platform for Pacific based investment.

its strong business and cultural links with Asia, and with a time zone straddles the Asian, European and US business days, Australia is ideally oned to provide the skills, resources and high quality, value-add services et Asia's development needs and its rapidly growing consumer market.

ed by the rapid growth of China and India in particular, it is estimated he number of consumers in Asia with incomes over US$5,000 per n will double from 434 million in 2005 to more than 860 million in 2010[3]. alia is perfectly positioned to access this rapidly expanding market.

tralia's top four merchandise trading partners are Japan, China, and the United States[4]. The United States, Japan, Hong Kong and pore are also among Australia's top ten sources of inward investment. Australia is well known for its commodity exports, services account most 80 per cent of economic activity[4]. Over the five years to 2004, alia's services exports to China alone almost quadrupled, while services ts to India and Korea increased by 131 and 86 per cent respectively[4].

tralia currently has Free Trade Agreements (FTAs) in place with the d States, Singapore, Thailand and New Zealand. It is also negotiating with China, Malaysia, United Arab Emirates, and ASEAN (Association Asian Nations), and is examining the feasibility of an FTA with Japan.

y investors from the USA have already discovered the competitive ntages of Australia as a place to do business, with the US accounting 5 per cent of the stock of all foreign direct investment in Australia.

So, with Australia being the fastest place in the world to start a business[5], your Asia-Pacific investment decision could not be simpler. **The future is here–in Australia.**

Don't make an investment decision in the Asia-Pacific region without visiting www.investaustralia.com

Australian Government
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INVEST IN AUSTRALIA AND JOIN THESE SUCCESSFUL COMPANIES

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- Eli Lily
- GE Capital
- General Motors Holden
- Hewlett Packard
- Honeywell
- IBM
- JP Morgan
- Microsoft
- Merck Sharp & Dohme
- Pfizer
- Reuters
- Verisign

AUSTRALIA | AT A GLANCE

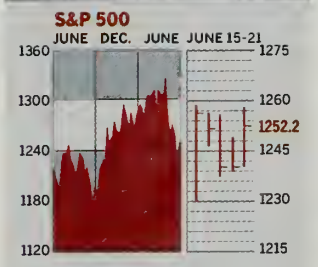
- World's most resilient economy – for the fourth year in succession (IMD WCY 2005)
- Lowest risk of political instability in the Asia-Pacific and second lowest in the world (IMD WCY 2005)
- Experienced a 90% increase in the stock of foreign direct investment over the last five years to US$211b in December 2005 (ABS 2006)
- 15 years of continuous expansion with forecast growth of 3.2% in 2006 compared to the OECD average of 2.9% (OECD 2006)
- Ranked first in the Asia-Pacific for overall productivity per person employed (IMD WCY 2005)
- No country in the Asia-Pacific region can match Australia's range of multilingual skills, with Chinese dialects being prominent (ABS 2006)

[1] Consensus Economics; IMF; economics @ ANZ **[2]** IMD World Competitiveness Yearbook (WCY) 2005 **[3]** Invest Australia estimate **[4]** Australian Bureau of Statistics (ABS) 2006 **[5]** World Bank 2005
*GDP based on purchasing power parity

HE FUTURE IS here Competitive Australia

Personal Finance Figures of the Week

STOCKS



COMMENTARY

After starting the week jittery over the prospect of higher interest rates putting a brake on the economy, stocks surged as housing starts increased more than estimated. Morgan Stanley, FedEx, and other companies beat analysts' earnings estimates. The Dow rose to its first close above 11,000 since June 2. Oil closed above $70 on favorable gasoline supply news.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	JUNE 21	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1252.2	1.8	0.3	3.2
Dow Jones Industrials	11,079.5	2.4	3.4	4.5
NASDAQ Composite	2141.2	2.6	-2.9	2.4
S&P MidCap 400	738.8	2.6	0.1	7.2
S&P SmallCap 600	361.4	2.0	3.1	8.2
DJ Wilshire 5000	12,567.0	1.9	0.6	4.4
SECTORS				
BusinessWeek 50*	709.1	2.4	-4.4	-2.0
BW Info Tech 100**	369.5	3.2	-2.9	3.0
S&P/Citigroup Growth	580.8	1.5	-2.6	0.0
S&P/Citigroup Value	669.6	2.1	3.4	6.5
S&P Energy	388.3	1.0	4.2	11.2
S&P Financials	429.7	1.9	0.8	7.8
S&P REIT	165.0	1.3	7.8	10.0
S&P Transportation	274.9	4.3	10.0	28.4
S&P Utilities	161.1	0.1	0.9	2.5
GSTI Internet	173.7	5.0	-15.3	4.2
PSE Technology	788.6	2.0	-5.7	3.7

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	JUNE 21	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1609.6	3.5	6.5	
London (FT-SE 100)	5665.0	2.9	0.8	
Paris (CAC 40)	4774.7	3.5	1.3	
Frankfurt (DAX)	5503.4	3.7	1.8	
Tokyo (NIKKEI 225)	14,644.3	2.3	-9.1	
Hong Kong (Hang Seng)	15,659.4	2.7	5.3	
Toronto (S&P/TSX Composite)	11,112.8	1.4	-1.4	
Mexico City (IPC)	18,156.2	8.1	2.0	

FUNDAMENTALS	JUNE 20	WEEK AGO	YEA
S&P 500 Dividend Yield	1.90%	1.92%	2.
S&P 500 P/E Ratio (Trailing 12 mos.)	16.7	16.4	2
S&P 500 P/E Ratio (Next 12 mos.)*	13.9	13.7	1
First Call Earnings Revision*	0.77%	0.64%	-0.

*First Cal

TECHNICAL INDICATORS	JUNE 20	WEEK AGO	RE
S&P 500 200-day average	1261.5	1260.7	Neg
Stocks above 200-day average	40.0%	37.0%	Ne
Options: Put/call ratio	0.97	1.03	Pos
Insiders: Vickers NYSE Sell/buy ratio	3.29	3.68	Neg

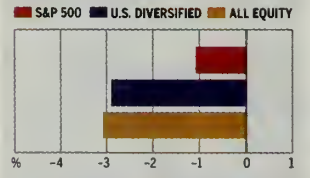
BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Spclzd. Cnsmr. Serv.	11.0	Steel	102.7
Motorcycles	8.4	Agricultural Products	80.5
Internet Retailers	8.0	Divsfd. Metals & Mining	64.4
Intgrd. Telecomms. Svcs.	7.3	Employment Services	60.5
Trucking	7.1	Railroads	49.9

WORST-PERFORMING GROUPS	LAST MONTH %		LA MO
Tires & Rubber	-13.8	Automobiles	
Electric Mfg. Svcs.	-12.4	Educational Services	
Commerical Printing	-10.5	Homebuilding	
Homebuilding	-9.9	Tires & Rubber	
Employment Services	-9.5	Home Entertainment	

MUTUAL FUNDS

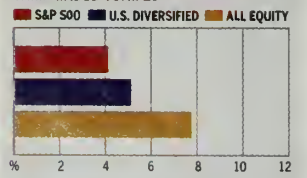
4-WEEK TOTAL RETURN

WEEK ENDED JUNE 20



52-WEEK TOTAL RETURN

WEEK ENDED JUNE 20



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Real Estate	2.0	Precious Metals	52.3
Utilities	1.9	Latin America	37.7
Health	-0.9	Diversified Emerg. Mkts.	26.4
Domestic Hybrid	-1.5	Japan	24.2
LAGGARDS		LAGGARDS	
Precious Metals	-9.3	Health	1.1
Latin America	-8.2	Large-cap Growth	2.2
Diversified Emerg. Mkts.	-7.6	Domestic Hybrid	3.4
Diversified Pacific/Asia	-7.5	Technology	3.5

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
ProFds. USh. Emrg. Mkts. Inv.	12.2	U.S. Global Invrs. Gold	85.2
ProFunds UltSh. Jap. Inv.	12.1	Midas	83.3
DireXion Emrg. Mkts. Sht.	10.8	U.S. Glbl. Invs. Prc. Mnls.	78.5
DireXn. Sm. Cap Br. 2.5X Inv.	10.3	ING Russia A	77.9
LAGGARDS		LAGGARDS	
Ameritor Investment	-25.0	Ameritor Investment	-75.0
iShares Silver Trust	-21.2	American Heritage Grth.	-33.3
DireXion L. Am. Bl. 2X Inv.	-17.5	Alpine U.S. Rl. Est. Eq. Y	-21.6
DireXn. Emrg. Mkts. Bl. 2X	-17.3	Frontier MicroCap	-20.8

INTEREST RATES

KEY RATES	JUNE 21	WEEK AGO	YEA
Money Market Funds	4.57%	4.55%	2.
90-Day Treasury Bills	4.91	4.89	3.
2-Year Treasury Notes	5.20	5.12	3.
10-Year Treasury Notes	5.16	5.06	4.
30-Year Treasury Bonds	5.19	5.09	4.
30-Year Fixed Mortgage †	6.67	6.52	5.

†BanxQuote

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BO
General Obligations	4.16%	4.
Taxable Equivalent	5.94	6.
Insured Revenue Bonds	4.17	4.
Taxable Equivalent	5.96	6.

THE WEEK AHEAD

NEW HOME SALES *Monday June 26, 10 a.m. EDT* » New home sales in May probably eased to an annual pace of 1.17 million units, after a rebound to 1.2 million in April. That's the median forecast of economists surveyed by Action Economics.

EXISTING HOME SALES *Tuesday, June 27, 10 a.m. EDT* » Existing home sales in May are expected to have fallen to an annual rate of 6.65 million units. Sales declined to a pace of 6.76 million homes in April.

CONSUMER CONFIDENCE *Tuesday, June 27, 10 a.m. EDT* » The Conference Board's June Consumer Confidence Index most likely eased to 102.9, from 103.2 in May.

FOMC MEETING *Wednesday, June 28-29, 9 a.m. EDT* » The Federal Reserve's Open Market Committee begins its two-day meeting to set monetary policy. Every economist polled by Action Economics expects the central bank to raise the fed funds rate by a quarter point, to 5.25%.

PERSONAL INCOME *Friday, June 30, 8:30 a.m. EDT* » Personal income probably increased by 0.3% in May, following a second straight gain of 0.5% in April. Consumer spending is also forecast to have grown by 0.3% on weaker auto sales. In April, outlays grew by 0.6%.

The *BusinessWeek* production i grew to 281.1 for the week en June 10, a 15.5% rise from previous year. Before calculatio the four-week moving average, index declined to 281.2.

BusinessWeek onli

For the BW50, more investme data, and the components of the production index visit www.businessweek.com/extras

...d full reports and related information, go to the links listed below or visit www.technology-reports.com

...elerate IT with Managed Services

...t comes to deploying and managing IT ...ure for new applications, a directive often ...n senior management is – "get it done", usu... ...panied by "now", "make sure it keeps up ...ng" and, of course, "stay on budget". For ...ons with maxed-out IT staffs and flat-line ...t can be a challenge to get these environ... ...o and running quickly. The problem ...more difficult when 24x7 coverage is need... ...port and problem resolution.

...rganizations are turning to Managed Service ...(MSPs) as an alternative or adjunct to inter... ...to deploy and operate IT systems. Managed Services helps companies save money, deploy systems faster and maintain higher levels of service availability and performance. Managed Services allow an organization to focus on what they do best – serve their end-user customers and grow their business – while the MSP does what they do best – manage and support IT systems around the clock with a full team of experts.

Managed Services fall into two general categories: Remote Managed Services and Managed Hosting Services. With Remote Managed services, the MSP monitors and manages the customer's infrastructure in the customer's data center. With Managed Hosting Services, the MSP delivers a service to the customer using the MSP's hardware and software hosted in the MSP's secure data center. Hosted Services are ideal for deploying both primary and Disaster Recovery (DR) environments. Some MSPs offer both remote and hosted as well as "blended" services.

The benefits of either flavor of Managed Services can be compelling:

- **Enforceable Service Level Agreements with financial penalties for non-compliance**
- **24x7 coverage for support and problem resolution**
- **Ability to leverage the MSP's broad technical expertise and best practices**
- **Single source of support – no finger pointing between vendors**
- **Faster deployment and upgrade times – days not months**
- **Reduce CapEx – IT delivered as a service**

To read the full report, go to www.technology-reports.com/fusionstorm.asp

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...ed by new compliance regulations, the rise ...ourcing, flattened budgets, and calls by ...ment to "run IT more like a business," ...e striving to impose formal processes on IT ...s. This push for rigor has led many CIOs to ...rganizing, managing, and delivering IT in ...m of well-defined, tightly-controlled IT ... This is largely uncharted territory for ...mpanies, so it's no surprise that IT organi... ...are looking for guidance and direction.

...rvice Management (ITSM), as defined by ...ractices such as the IT Infrastructure ... (ITIL), is often referred to as ERP for IT. What it represents is a chance for IT to get out from the backbreaking grind of constant firefighting by way of planning, communication, and structured response. Talking to those who have implemented IT Service Management, it is difficult to overstate the potential benefits: reduced costs; improved productivity, communication, and morale; reduced time-to-market; and competitive advantage.

What is often overlooked in the scramble to adopt ITSM/ITIL, however, is that for ITIL to provide the promised returns, it must be applied in a way that leverages specific strengths and minimizes specific weaknesses. Standards are, after all, standard. Companies that do not exercise discipline and restraint in applying ITIL to their specific environment will undoubtedly find themselves faced with yet another revolutionary approach that falls short of expectations.

And yet, it is worth mentioning here that the single biggest reason most IT projects fail has nothing to do with technology, but rather with a lack of participation and buy-in. Change is uncomfortable and must be lead from the top. End users – e.g., lines of business, functional departments, customers, suppliers, and partners – must provide a clear understanding of their requirements and constraints, and be actively involved in discussions of potential benefits and trade-offs.

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Data Control and Audit Technology Protects Global Supply Chain Information

As corporations seek to extend their use of offshore suppliers to take advantage of unique expertise, or to reduce the cost of operations, they often expose themselves to increased risk. Sharing intellectual property, financial data, and/or customer private records with offshore partners can often open the door to significant financial loss, or risk to reputation, if the data is misused or compromised. The only hope of maintaining control of these key assets is to protect the data by technical means, or to isolate those who have access to it.

Recent developments in Data Control and Audit technology now make it possible to protect information where it is most vulnerable – in the hands of end-users as they work with and move data across applications (i.e., office, and remote legacy and Web applications), removable storage devices (i.e., USB flash drives), and various channels of communication (e-mail, Web-mail, FTP, etc.). Data Control and Audit technology automatically monitors the use of data on desktops, laptops, and/or servers, restricting a user's ability to transfer, copy, or print sensitive data based on centrally distributed rules and policies.

This technology has now matured to the point where it can operate autonomously computer device, even when removed the network. This provides a unique abi protect multiple types of data, and the in ty of underlying business processes, ev isolated locations within a complex colla tive supply chain. It also has the added of creating a "virtual data perimeter" a valuable corporate information and impr accountability, without impacting ex business processes. By using Data Contr Audit technology, it is now possible to ce ly protect and track the 'flow' of data th a global supply chain, while maintain complete audit trail of its use.

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Enabling Leaders to Lead: Getting back 30% of your time!

Executives lead with strategy and act with agility to deliver profitable growth. Studies show up to 30% of executive management time is impotent because of inaccurate and inconsistent information. This includes not having the right tools to overcome this challenge.

Leaders find themselves managing escalations, researching status of projects, or trying to digest a constant barrage of updates. The result is an inefficient use of the Leader's time and knowledge. What is a Leader to do?

Companies with progressive Leaders are successfully optimizing their performance by enabling solutions that provide for increased visibility, accountability, and control.

These enabling solutions incorporate many critical elements: 1) **closed loop management** ensures accountability of actions for control and resolution 2) an **integrated tool suite** facilitates change that augments your skills set, 3) creating **real-time visibility** into all activities to promote a sense of urgency 4) **availability on demand** to increase flexibility and provide instant access and 5) **exception based reporting** to focus management attention and support.

Managing current functions while innovating for the future is a delicate and demanding balanc- ing act. Having the skills and tools to incre ability to adopt and advance change is competitive advantage.

This may require you to team with oth acquire the tools and knowledge to acc change and performance. Streamlining the to improve information quality will redu time to make decisions.

This will lead to improved communication enables organization synergy and momentum

Instead of getting tied up in the daily rout chasing information and other tactical activiti up your time to drive the future state.

What would you do if you got back 30% time each day? Take charge of your future toc experience the difference.

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siness and IT Process Automation Everyone. Has It Arrived?

ential growth in data digitization and a glob- titive landscape has significantly increased and IT processes. This trend is on the rise n ever-increasing number of software and r users. Organizations of all sizes are facing an s challenge to better manage these processes. emma is how to automate these tasks with- investments in a dynamic IT environment. sses have always focused on automating tasks se efficiencies and reduce operational costs. , in the past solutions available required large nts of resources, time and money, limiting ity to large enterprises and very complex processes. Extensive 'justification' requirements, lengthy, risky and difficult integrations with long ROI periods were commonplace. Until recently the true benefit of automation remained elusive to many.

Fortunately, emerging trends are helping change this scenario:

1. The new wave of do-it-yourself automation software focusing on ease of use leads the way. They offer zero-consulting and significantly reduced software costs, providing a time to value in just days.

2. New intelligent technologies are better able to shield end-users from automation complexity. For example: wizard based approaches, no-programming required and painless record and replay software are gaining momentum.

3. Software today is more adept at communicating in a standardized manner. Web interfaces, standardized data formats and Windows based applications have made it much easier to automate. For example: automating legacy systems was a daunting task, but now these systems provide web interfaces that allow easier automation.

Automation software now caters to every sized company and even individuals. *The era of affordable, usable automation software has arrived.* Organizations can now automate simple or complex processes, or even just individual tasks and realize the benefits of quick ROI, reduced costs, reduced human error and increased productivity.

To read the full report, go to www.technology-reports.com/tethys.asp

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l-Time Application Performance nitoring: The Measure Of Network ROI

lly all enterprises today invest significantly in a-networking infrastructure. But how often e expenditures measured in terms of the hey have on the quick, efficient, and secure of application services to users? Or in other ow is the impact of a technology investment d against the value it can provide?

ROI of any infrastructure investment can measured in terms of how much it improves experience (and thus productivity) of mis- ical application services. The ideal method- or measuring this impact is Real-Time ion Performance Monitoring, which uses live network data gathered from actual traffic, rather than sampled from network devices or synthetic agents. This enables it to deliver an accurate, real-time and historical picture of network traffic and user experience for all application and users, even across networks owned by third parties from which data is not normally accessible, such as those controlled by ISPs, partners, and customers.

This technology can thus deliver data about the performance of an enterprise's core application that makes clear how much a proposed expenditure will contribute to improved application delivery. By giving the enterprise the ability to baseline the performance of all applications and spot weak points in the data networking infrastructure, no matter where they're located, real-time application performance monitoring enables managers to make much more informed choices about which data networking infrastructure projects should be funded and in what order. Moreover, "before and after" performance baselines on live transactions not only helps assess the ROI of an infrastructure expenditure but can also help in technology brand or model selection.

Real Time Application Performance Monitoring technology brings tremendous tactical value to enterprises in its ability to monitor and troubleshoot real-time application performance, as well as tremendous strategic value as a Network ROI calculator and technology selection instrument.

To read the full report, go to www.technology-reports.com/[illegible].asp

arnet design, inc.

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Get Control of Your Telecom Costs and say Goodbye to "Stare and Compare"

Telecommunications expenses for a typical enterprise average over three percent of its revenue. According to Gartner, two to fourteen percent of these charges are billed in error resulting in $8.0 million a year in lost profits for large firms and $1.8 million in lost profits for mid-sized firms. Managing these expenses is labor intensive, complex, costly, and typically not a company's core competency.

Telecom Expense Management (TEM) challenges include: (1) controlling telecommunications and network service expenses (2) managing continually changing and expanding telecommunications networks, including wireless and data services, (3) processing, validating, auditing, and approving large volumes of invoices through labor-intensive methods, and (4) aggregating and analyzing data from decentralized networks to optimize network expenditures.

Business Process Outsourcing (BPO) of TEM allows the enterprise to leverage scalable processes, technologies and people lowering costs, and enabling an enterprise to focus on its core competencies. The benefits of TEM BPO include:

- **Asset Management** identifies and manages dynamic teleco and services across the enterprise.
- **Increased Productivity** is gained by transferring a non-cor processing function to a best-in-breed, focused BPO.
- **Improved Validation and Auditing** by accurately identifyin billing errors in a timely manner.
- **Central Control** of all voice, data, and wireless expenses.
- **Best Practices** are integrated into the TEM process throug provider's domain expertise and enhanced internal controls
- **Vendor Relations** improves the timeliness for processing t nication invoices, minimizing late payment penalties and un service disconnects.
- **Total Cost of Ownership** is reduced by taking advantag TEM BPO economies-of-scale and singular focus withou mental investment.
- **Data Integrity and Intelligence** are delivered via access t detailed, timely, centralized, and understandable data.
- **Sarbanes-Oxley Compliance** is achieved via the BPO pro SAS 70 Type II report.

To read the full report, go to www.technology-reports.com/controlpoint.

controlpoint SOLUTIONS

Control Point Solutions is the leading provider of BPO of TEM. The firm manages the entire expense lifecycle for voice, data, and wireles ices. Control Point Solutions manages over 1.3 million telecommunications invoices totaling over $7 billion for their clients, and has r client expenses by more than $1.5 billion. Enterprise, Carrier, and Government clients leverage Control Point Solutions' domain expertis ple, processes, and technology to gain process efficiencies, actionable intelligence, sustainable cost reductions and control. **www.controlpointsolutions.com • 800.93**

Email, IM, Web and VoIP Converge: Are You Secure and Compliant?

Convergence, we have all heard it, but what does it really mean for businesses today? Convergence enables users to consolidate their traditional and IP-based communications -- Email, IM, Web and VoIP -- on a single device or application. Early examples include Microsoft's® Exchange, LCS, and SharePoint that provide an integrated platform for IP communications. In the handset world, the BlackBerry® and smart phones have evolved to provide users with a single device to meet all their communications needs.

This convergence of technology opens the door to new opportunities in communications, but also introduces new security concerns. A converging threat landscape brings the risk of multiple attacks while also the need to ensure corporate, regulatory compliance and privacy requirements are met. As new blended threats emerge such as virus infected messages used in spam campaigns it is critical to enforce a single policy across all IP communications. Organizations can no longer rely on conventional point products and reactive threat prevention services to secure their networks and meet compliance and privacy requirements. Added to this is the additional strain of new complexities where information can be sent and received over multiple IP cor cations channels simultaneously.

***"Threats are changing and business commun are using more and more network protoc Enterprises need next generation security so that efficiently and effectively protect a communications channels," said John Pesc* Vice President and Distinguished Analyst of Gart**

Bottom line: In order to be secure and ant, organizations need a single content platform to prevent attacks, block unwant tent, control confidential and private i tion, and manage the messaging infrast centrally, across all IP communications -- IM, Web and VoIP.

To read the full report, go to www.technology-reports.com/borderwa

BorderWare™

BorderWare Technologies makes Internet communications safe. The company is the leading provider of content and application s that secures business-critical applications including Email, Instant Messaging, Web and Voice over IP. For over 12 years, BorderW helped organizations mitigate business risk by: reducing the complexity of a multi-vendor security environment; ensuring busines nuity; and reducing exposure to legal liability by ensuring corporate and regulatory compliance and privacy requirements are met. **877-814-7900 • www.borderwa**

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ctronic Discovery Systems Meet w Legal and Technological Needs

of the major lawsuits recently in the press the review of volumes of data greater than l in the Library of Congress; many lesser- cases go to similar extremes. As litigation vernment investigations grow in number nplexity, so grows the amount of material to be reviewed during discovery.

sing the right discovery solution is critical orations to manage costs and control risk. rong choice is made, documents may not able for review, be in the wrong format, or en corrupted; the larger the scope of dis- the larger the risk. Because of the tight deadlines involved with discovery, it's no longer practical to wait for a subpoena before putting a document discovery process in place. Many organizations are building powerful electronic discovery systems and processes into everyday operations in order to minimize the impact to their business when a document request is received.

Implementing an e-discovery system into normal business practices and the document life cycle management also helps manage costs. Such a system identifies and stores documents in a sensible, comprehensive manner that reduces risk of adverse outcomes; reduces confusion by putting operational, legal and technical personnel on the same page; and lowers costs by preventing duplication of review work.

Ideally, each relevant document should be processed only once, even when it bears on multiple cases. Documents should be accessible to multiple authorized parties, and displayed in a single format within an intuitive interface that makes the system easy to use.

Today, the risks of not having an e-discovery system are greater than the cost of implementing one. Discovery preparedness can make or break a company's future, and more companies are turning to full-service providers for comprehensive solutions.

To read the full report, go to www.technology-reports.com/LexisNexis.asp

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e Best Defense is a Good Offense

's cyber-threat environment is increasingly over 90% of companies have anti-virus, anti- nd firewall defenses, but attacks and malware getting through. Additionally, the threat is ng from the inside-out. Challenges posed by both financial and operational. Financially, itions are legally liable for sensitive data, rices get impacted upon disclosure, revenue are disrupted, and human 'firefighting' cre- necessary, expense to fix. Operationally, the rtment doesn't add value, business services upted, and employee confidence reduced. needed is a new type of security element that pervades the network and automatically protects organizations from a broad variety of attack types (e.g., worms, viruses, Trojans, DDoS, Spyware) and from all potential points of attack.

Intrusion Prevention Systems (IPS) are the best step in this direction. In the simplest sense, an IPS is a computer appliance that blocks attacks before they can reach their target. In a broader sense, an IPS performs total network packet flow inspection, with deep analysis and classification by receiving constant security filter updates to protect against threats.

Security effectiveness is measured in three dimensions: accuracy, coverage, and timeliness. Of these, accuracy is the most important. Accuracy ensures malicious traffic is blocked, and legitimate traffic is not. Coverage refers to the breadth of attacks or attack vectors that an Intrusion Prevention System can protect against. Timeliness is the speed with which an IPS offers protection against a new threat. If filters are in place, they can protect an organization preemptively before the existence of an exploit or worm.

IPS represents a philosophical shift from traditional reactive security tools like firewalls and intrusion detection systems that require extensive configuration, tuning and manual maintenance, to an automated security solution. Therefore, organizations should heed what doctors often say "the best form of defense is prevention".

To read the full report, go to www.technology-reports.com/tippingpoint.asp

ppingPoint
a division of 3Com

TippingPoint is the leading provider of network-based intrusion prevention systems with innovative features including spyware protection, quarantine protection, phishing protection and multi-gigabit throughput. TippingPoint's IPS offers accurate, automatic blocking of malicious traffic, VoIP security, bandwidth management and centralized management to all types of enterprise, government, and education organizations. Austin, TX • 512 681 8000 • www.tippingpoint.com

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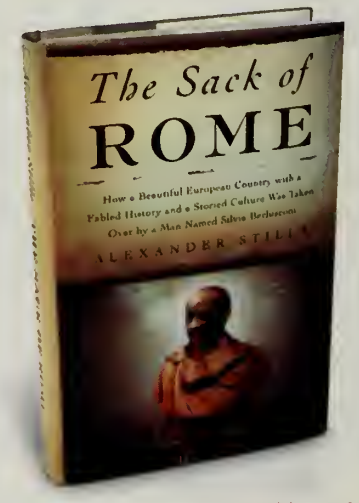
Barbarian in the Palace

THE SACK OF ROME How a Beautiful European Country with a Fabled History And a Storied Culture Was Taken Over by a Man Named Silvio Berlusconi
By Alexander Stille; Penguin Press; 384pp; $25.95

Media mogul Silvio Berlusconi leaped onto the Italian political stage a decade ago and cast himself as the country's most successful businessman—an outsider untainted by corrupt politics and a go-getter ready to apply American-style entrepreneurial verve to an ailing economy. Given his $14 billion net worth, who was going to challenge that claim? For millions of voters disgusted by rampant political sleaze, Berlusconi's carefully honed image as an earnest, hard-working, financially capable chief executive answered a deep national longing.



The real Berlusconi is less the talented CEO than a savvy, unscrupulous salesman, argues investigative journalist Alexander Stille in his blistering account, *The Sack of Rome*. Despite his nose for the market, Berlusconi stumbles repeatedly in business, skirting financial crises by appealing to rich and powerful allies. The book describes deceptions ranging from claims of having studied at the Sorbonne (he attended the state University of Milan) to making repeated vows to remedy his colossal conflicts of interest. The engrossing tale describes Berlusconi as someone who seduced secretaries to make high-level contacts, ruthlessly deployed cronyism for maximum financial gain, bought off critics and tax inspectors, changed laws to derail criminal lawsuits against himself, and kept men on his payroll who bribed judges and colluded with the Mafia. The book's only weakness: Its detail can be overwhelming.

As Prime Minister from 2001 to 2006, media impresario Berlusconi owned or controlled all six of Italy's national television networks—90% of the country's airwaves. The author, whose previous books include an illuminating history of the Italian Mafia, *Excellent Cadavers*, artfully documents the raw might of Berlusconi's media to warp public opinion by ignoring and distorting the truth or broadcasting outright lies. For example, Stille shows how Berlusconi's allies planted and then fanned mysterious, unsubstantiated claims of bribery against a possible rival, Antonio Di Pietro, the former star prosecutor who had pilloried a corrupt political class during the 1990s. By 2001, he writes, 77.4% of Italians got their information from TV and only 6.4% from newspapers. Berlusconi knew his audience: millions of voters with little better than a 7th-grade education who "knew little about politics and cared even less."

Berlusconi's approach is at once straightforward business and appalling politics. His advertising executives founded h party, directed his political campaign, and then ran for office themselves. Many associates, including his defense lawyers, stayed on his payroll after becoming Parliament members. S contends that Berlusconi steadily stuffed public institutions public TV with backers until he controlled thousands of key positions in the state bureaucracy and the media. "After nea decade of Berlusconi in public life, Italy had increasingly be to resemble a kind of company town, where everyone works the local factory, lives in company housing, buys at the com store, and in which order is kept by the company guards.

Berlusconi filled the average Italians' days fr the morning newspaper to the nightly news,' says the author.

Berlusconi constantly claims that left-leaning, politically motivated prosecutors h been out to get him. Stille debunks that my tracing many key charges against the Prim Minister to the days before he entered polit By tracking several trials and the laws pass by his government, Stille highlights how Berlusconi and his cohorts thwarted the criminal justice system. Political allies were elected "so that they could enjoy parliamen immunity from arrest and vote on legislatio water down the Italian penal code."

Having deflated the idea that Berlusconi efficient CEO, Stille explains his appeal as a alluring showman-politician. A former crui ship crooner, Berlusconi is portrayed as distracting the masses from bad tidings by boasting about his sexual prowess, disappearing for a face-lift, or likening himself Jesus. Like a talk show host, is relentlessly upbeat, a tad outrageous, and always entertaining.

Stille shows the raw power of Berlusconi's media to warp public opinion

No question, Berlusconi' reign was disastrous for the economy: Italy's global competitiveness ranking slipped 28th to 41st, lower than that of Namibia, according to the Institute for International Management in Lausanne. But broader lesson of the mogul's political career is even mor depressing: Western democracies remain dangerously vulnerable to media manipulation, allowing countries su Russia to easily dismiss Western criticism about political control of their media as gratuitous. *The Sack of Rome* is a frightening case study and one that has plenty of bearing our own media-driven politics. ■

–By Gail Edmon

ONE OF THE FASTEST GROWING G7 ECONOMIES ISN'T EVEN A COUNTRY.

There are many reasons why the economic growth of Ontario is predicted to outpace Germany, France, and Japan this year. And why, at over $400 billion, our GDP is already greater than Switzerland's or Sweden's. Our dynamic economy is diversified from automotive to food products, and aerospace to IT and communications. We're located in the heart of North America, with a reach of 420 million people. Most importantly, we're built for business. Ontario is the economic center of Canada, which is the lowest-cost G7 country for conducting business, according to a 2006 KPMG study. We also offer the best-educated workforce in the world, universal healthcare, and a commitment to bring commercial innovations to market. It's enough to make any nation proud. There's no better place in the world to do business.

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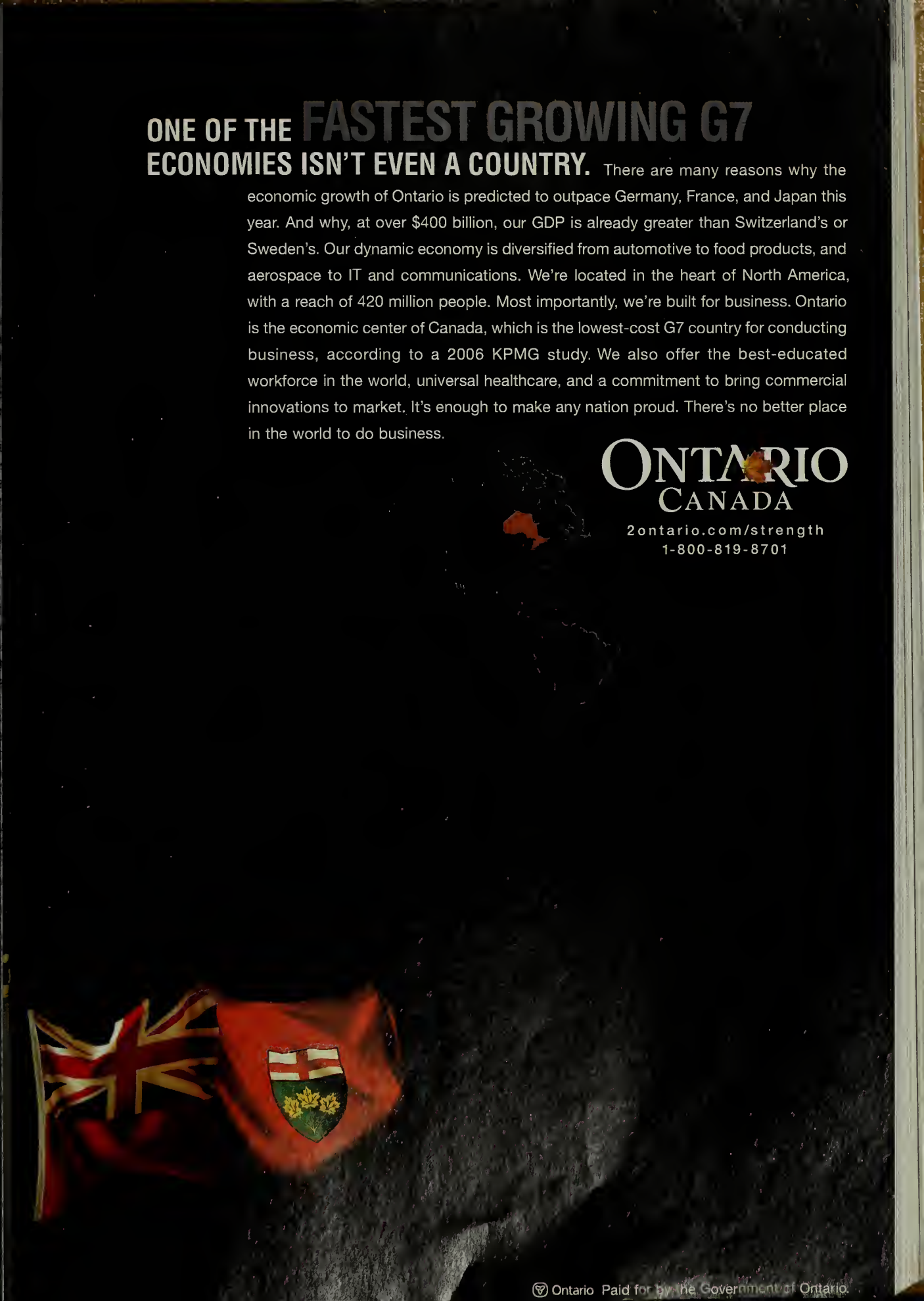

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IdeasOutsideShot

BY ROBIN HANSON

The Myth of Creativity

Creativity is in. Seminars teach employees to "think outside the box" and release their inner Picasso. Managers preach innovation, and today's rich and powerful prefer to describe themselves as creative heroes, valiantly besting the naysayers to bring us the radical changes that add up to progress. Richard Florida's best-selling *The Rise of the Creative Class* argu

that societal progress increasingly comes from places like New York and San Francisco, in part because those cities encourage creativity by embracing bohemian self-expression and openness to diversity in dress, speech, or even sexuality.

Despite this affirming chorus, much of the hoopla over creativity is a crock. Why? Because we are already up to our eyeballs in it. Make no mistake: Innovation matters. Nothing is more essential for long-term economic growth. But to get more innovation we may want less, not more, creativity.

The sobering truth is that the dramatic artistic creations or intellectual insights we most admire for their striking "creativity" matter little for economic growth. Creative new clothes or music may change fashion, but are soon eclipsed by newer fashions. Large and lasting economic innovations, like steam engines or cell phones, are rare and tend to be independently "invented" by many people. One less visionary would matter little.

Instead, the innovations that matter most are the millions of small changes we constantly make to our billions of daily procedures and arrangements. Such changes do not require free-spirited self-expression. Instead, people quite naturally think of changes as they go about their routine business and social lives.

Innovation matters, but releasing your inner bohemian isn't the answer

IN FACT, HUMANS GENERATE far more suggestions than we could ever possibly pursue. We throw away most ideas, while those we do bother to mention are rarely pursued. Almost everyone has suggestions they think were unfairly ignored. This is not because of evil conformism; given our limited resources, it simply could not be otherwise.

Where's the biggest surplus? All those "big ideas." After all, big changes take even more resources to pursue, and people long to be creative heroes celebrated for their big ideas. It seems every actor wants to direct, every musician wants creative control, and every manager wants to be a CEO.

Such striving for creativity can actually reduce innovation. Vying for creative credit, people routinely neglect good ideas "not invented here." And they often join the crowd behind new idea just to declare their creativity, which distracts th from really trying to make that new idea work.

To succeed in academia, my graduate students and I ha learn to be less creative than we were initially inclined to l Critics complain that schools squelch creativity, but most people are inclined to be more creative on the job than wc be truly productive. So schooling is mostly about selecting smarter and more diligent, and learning to show up day a day to somewhat boring jobs with ambiguous instruction

What society needs is not more creativity or suggestions change but better ways to encourage people to focus on important issues, identify the most promising ideas, and tell the right people about them. Bu our deification of creativity gets in the way.

We laugh at our ancestors who believed in "trial by combat" because God made morall virtuous people physically stronger. But our myth of creativity similarly associates creati with moral virtue. Artistic achievement is thought to require deep, almost spiritual sel awareness. Indeed, Richard Florida says creativity favors "individuality, self-expressi acceptance of difference, and the desire for r multidimensional experiences" instead of "homogeneity, conformity, and 'fitting in.'" Creativity is said to come not to those who t control it, but to those who let it control ther

This is a *Star Wars* vision of innovation: "Feel the force Luke; let go of your conscious self and act on instinct." A is just as much a fantasy as that celluloid serial. Innovatic no more about releasing your inner bohemian than it is a holding hands, singing *Kumbaya*, and *believing* in innova

In truth, we don't need more suggestion boxes or more street mimes to fill people with a spirit of creativity. We instead need to better manage the flood of ideas we alrea have and to reward managers for actually executing them

Robin Hanson *is an associate professor of economics at Geor Mason University and a Mercatus Center scholar. A version o essay appeared online at Cato Unbound (cato-unbound.org).*

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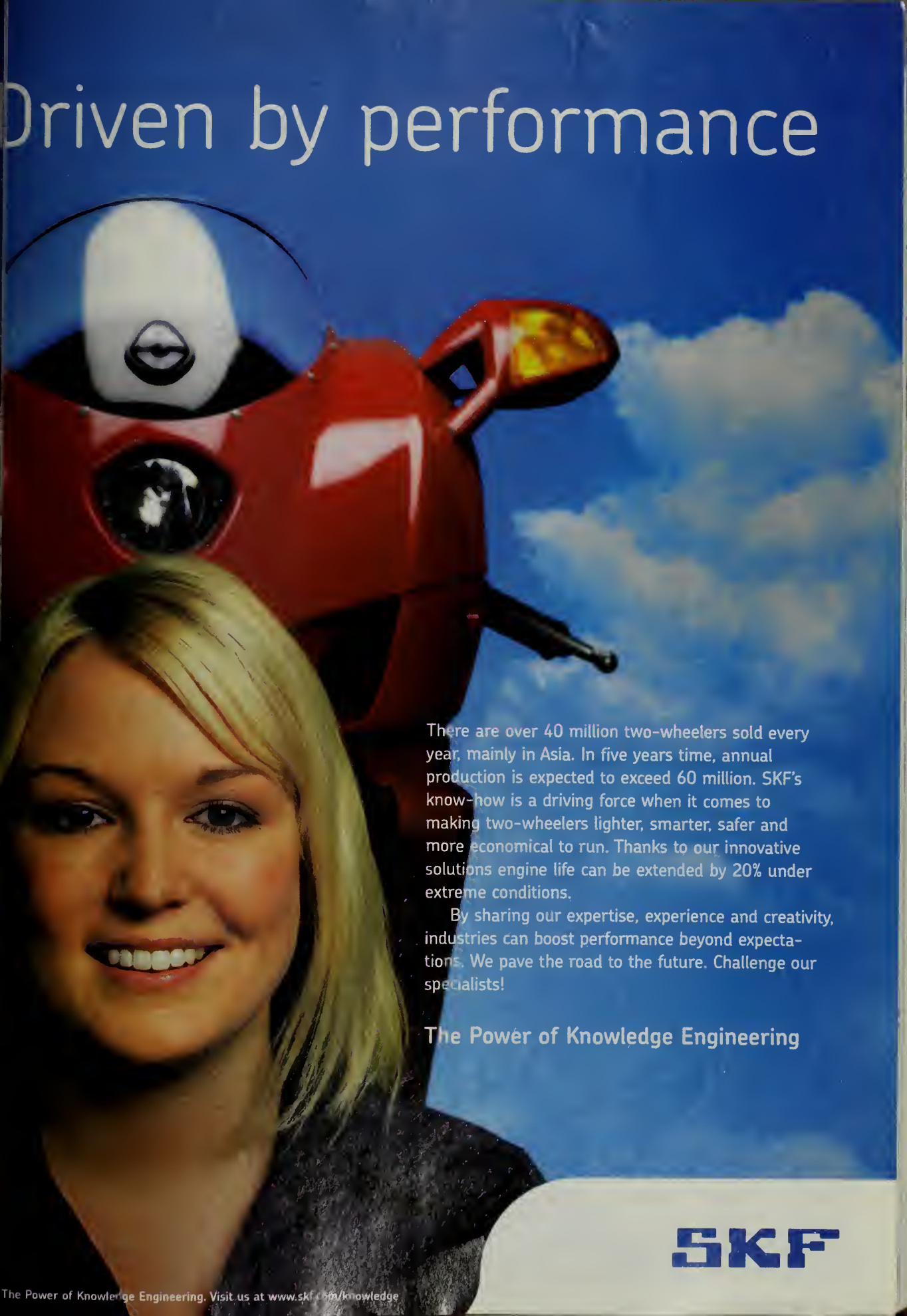
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Ideas The Welch Way

BY JACK AND SUZY WELCH

Are You a Boss-Hater?

My wife and I regularly see incompetence, tolerance for stupid decision-making, and outright unprofessionalism at the companies where we work. Why is it so hard to find a manager you can respect, follow, and learn something from?

–Eric Hoagberg, Barrington, Ill.

It's not hard. But it does require a certain mindset, one you may have difficulty finding in yourself. If so, you're not alone. Every week we receive several e-mails that sound like yours. The wording and details are different, but the underlying question is always the same: Why am I the only person at my company who gets it?

We realize there are days when it can feel as if everyone around you is inept. Companies, after all, are composed of people, and people screw up, reward mediocrity, play politics, and otherwise commit myriad organizational sins. But the "everyone's dumb but me" attitude is dangerous. Not only is it a career-killer, but it's also simply not a realistic perspective on business. How do you explain the thriving, creative financial-services industry? Or the envelope-pushing genius of the life-sciences field? Or the incredible list of new businesses that have sprung from the Internet? Too many companies perform well every day—returning billions in profits by inventing, making, selling, and distributing millions of products and services—for every manager out there to be a total nincompoop.

If you're chronically disgruntled and see yourself as a victim, take this quick mindset test

That's why we suggest that you reflect on your own gloomy view of the working world. To be direct, we are wondering if you might be a boss-hater.

Very few people would ever identify themselves as boss-haters. They usually see themselves as noble victims, speaking truth to power. Forget that line. Boss-haters are a breed. It doesn't matter where they work—big corporations, family companies, partnerships, nonprofits, newspapers, or government agencies. Boss-haters enter into any authority relationship with barely repressed cynicism and ingrained negativity toward "the system." And even though their reasons may be varied, from upbringing to personality to political bent, boss-haters are unified in their inability to see the value in any person above them in a hierarchy.

The boss-haters in any organization tend to find each o and once in numbers, they usually become quite outspoke Boss-haters also tend to be on the high-IQ side. That's unfortunate, really. Because instead of using their intellig to improve the way work is done, boss-haters focus, laser- on all of the organization's flaws and the sheer, incomprehensible idiocy of the higher-ups.

Of course, because of their intelligence, some boss-hate do get ahead—briefly. More often, the organization feels t vibe, and bosses respond in kind, with distancing or wors

Now, maybe you're not a boss-hater. But the sweeping nature of your question suggests no shortage of contempt those at the top. Perhaps, then, you should give yourself a Think of a boss you've encountered who didn't have a problem. If you can't, the problem may be something you fix just by opening up your mind.

I have just been hired in a leadership position at a new comp I am tempted to bring along some people from my old organization. We work well together, and they have the skills! Your thoughts?

–Aakash Ganju, Bangalore, I

A tempting idea, but a tricky one. The answer is: It depen

If you're running a company that requires a rapid turnaround in a changing environment and you're saddle with an embedded culture of employees in a state of deni you'd be smart to bring along capable former colleagues. Together, you'll get the work done faster and more smoot and, with the camaraderie born of your shared experienc the past, it will be a lot more fun, too.

But if you've been hired to lead a relatively good busin that mainly needs a dose of reenergizing, hiring several members of your old team can create a lot of mayhem for little gain. Nothing is more discouraging to a functioning organization than an imported cabal that repeatedly says "This is how we did it at our old company." In the worst- scenario, this dynamic gives rise to a two-class society: th boss's favored insiders and the alienated has-beens.

Bottom line: Survey the terrain. Bring in your old team only if you need fast change. If you're not in crisis mode, search out the best of those you've inherited and give the new sense of purpose. You may miss your former colleag but you sure won't miss the havoc they could cause. ■

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at **thewelchway@businessweek.com.** *For their weekly podcast, go to www.businessweek.com/search/podcasting.htm*

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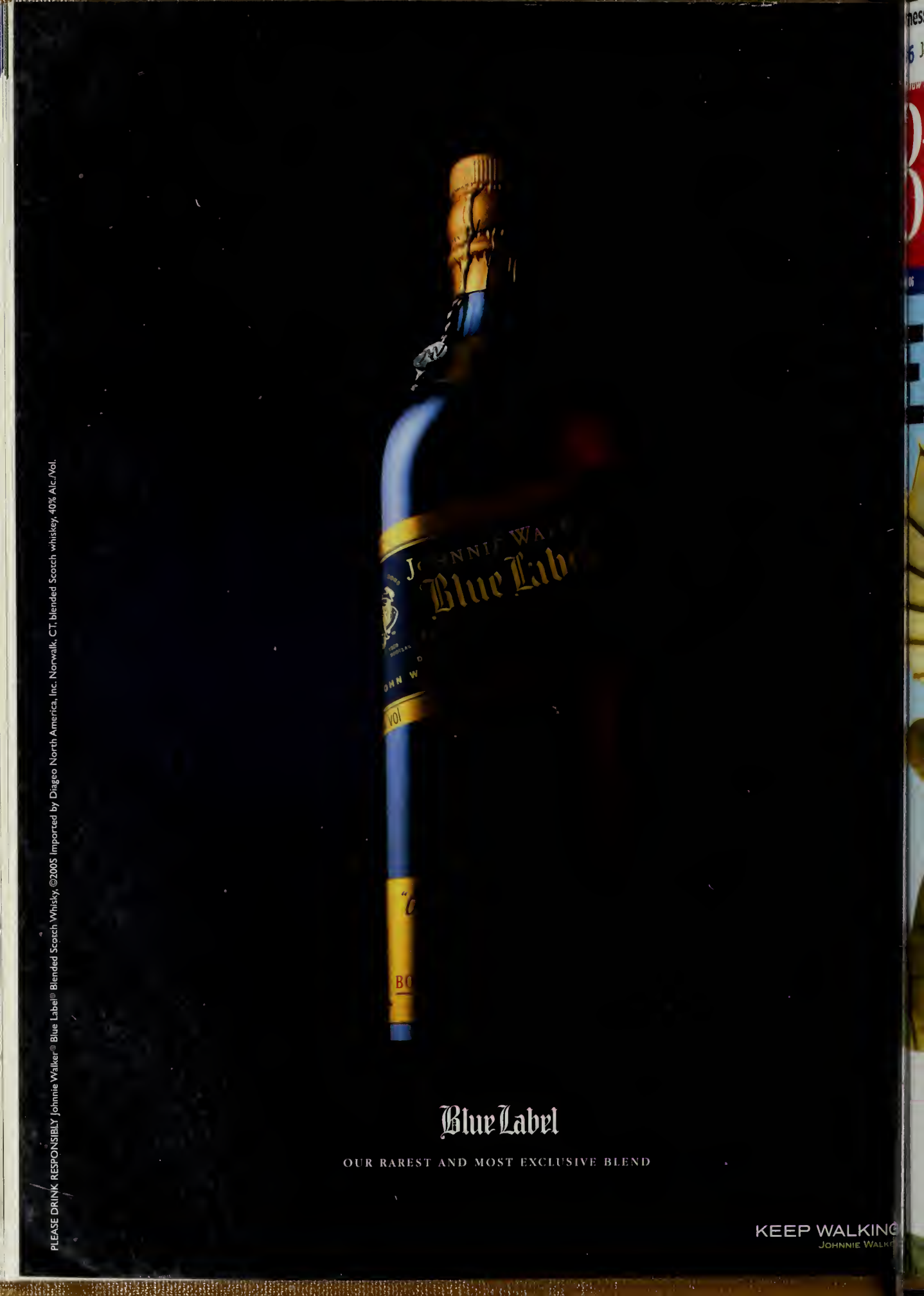
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Eureka, We Failed!

How Smart Companies Learn From Their Flops

BY JENA McGREGOR (P. 42)

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STARTING YOUNG

IT'S NOW CONSIDERED THE BEST WAY TO FIGHT OUR GROWING OBESITY PROBLEM

Hit the rewind button. Thirty years ago, American society hadn't yet traded the playground for the computer screen, adopted a diet chock full of fast food or learned to say "Supersize Me."

Recognizing what's changed since those slimmer days is an important step in reshaping the future. Faced with a generation of Americans whose weighty problems are starting to strain the medical system, health care experts are launching a society-wide effort to bring back such things as longer recess, safer playgrounds, walkable sidewalks and healthier school lunches. The primary focus of their efforts: It's kids.

Why kids? For one thing, they are more adaptable. Establish good nutrition and exercise habits when they're young, and chances are good that those healthy behaviors will stick. "There is no question that obesity is very difficult to treat once it develops," says Dr. Stephen R. Daniels, professor of pediatrics and environment health at Cincinnati Children's Hospital Medical Center. "Starting earlier gives us a better shot."

Research shows, for example, that kids who participate in some kind of obesity programming can do very well. "In fact, they do much better than their adult counterparts," says pediatrician Lorna Friedman, senior medical executive at CIGNA Healthcare. That's the good news, she says.

The bad news: Some 15% of children are currently considered obese. That compares to the early 70s when obesity rates were closer to 5%. In some populations, the current numbers are even higher. In New Jersey, a full 20% of sixth graders are obese, and another 19% are overweight.

Translate those statistics into health problems, doctors say, and the trend is even scarier. "We are starting to see health outcomes in children that had previously only been seen in adults," says Dr. Jeffrey P. Koplan, vice president for academic health affairs at Emory University and chairman of the committee that authored the Institute of Medicine's 2004 report, "Preventing Childhood Obesity." Type II diabetes, once virtually unknown in children, is a prime example, he says. "What previously could be tossed off as aesthetic, now is being seen for what it really is—a serious risk factor for disease." There are other costs as well. Obese children are more likely to suffer from low self-esteem and depression. And as they grow up, there's a 70% chance that they will stay obese. Indeed, the rise of obesity, unhealthy eating habits and physical inactivity has prompted the U.S. Surgeon General to warn that we may see the first generation with a "shorter lifespan than their parents."

> *"Establish good nutrition and exercise habits when they're young, and chances are good that those healthy behaviors will stick."*

A recent Rand Corporation study found that obese people spend 36% more on health care services and 77% more on medications. Other studies set the national health care cost of obesity and overweight conditions in adults at between $98 billion and $129 billion a year. "That's nowhere near the full impact of the obesity epidemic," says Dr. Koplan. Even if obesity rates level off, costs will continue to rise as today's obese children become adults.

Finger-pointing is counterproductive. "It's not one group's fault or responsibility," says Vickie James, R.D., L.D., of Healthy Kids Challenge, a nonprofit organization that's taking its emphasis on fitness and nutrition to the schools. "It is everyone taking simple, small steps together." These simple steps, however, add up to a major overhaul of some deeply entrenched aspects of American life and business. The new Institute of Medicine report has thrown down the gauntlet, calling for major change in everything from what's put in the school vending machines to what's put on the television screen. Likened by some to the first surgeon general's report on tobacco, the report makes far-reaching recommendations on issues as diverse as local zoning ordinances, health plan incentives, media advertising and the family television.

By focusing on kids, these experts also hope to create a ripple effect. "There are very few people in this country who aren't connected to a child," explains Ms. James. By mobilizing society to focus on kids, she says, the message gets delivered to everyone.

Help.

Carrots don't come in nacho cheese flavor. So it's no surprise kids are more willing to sit down with a bag of chips than eat something nutritious. Unfortunately, such habits tend to grow with kids into adulthood, when obesity can cause serious physical and emotional problems. At CIGNA® we realize obesity can affect the home as well as the workplace. With the Healthy Kids Challenge we're working with families and physicians alike on the importance of eating healthy and exercising at a young age. After all, playtime is just as important when you're an adult. For more information on CIGNA employee benefits, ask your employee benefits manager or visit us at **www.cigna.com/obesity.**

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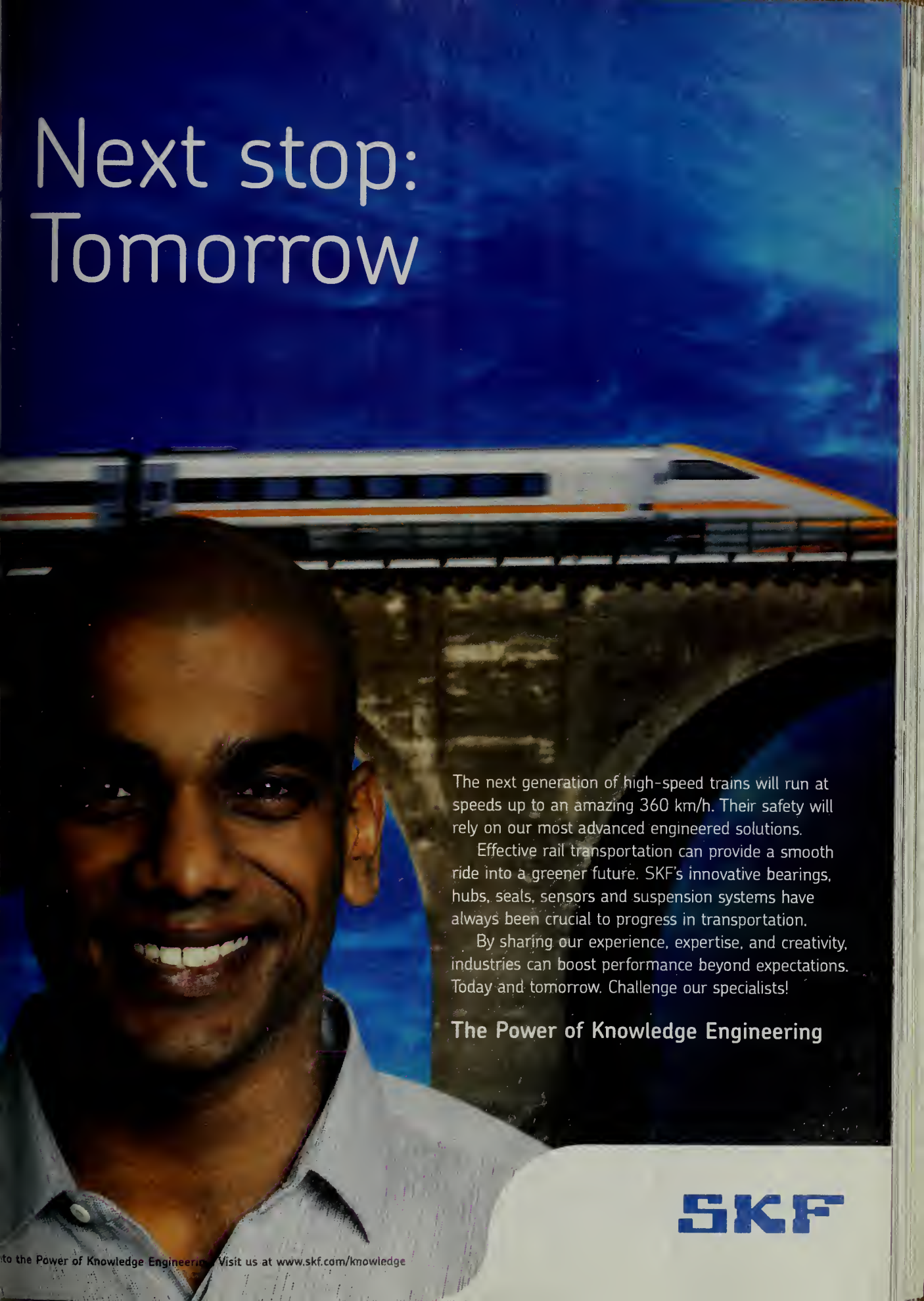
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JP Front

"If I make a mistake with my own money, it isn't as big as making a mistake with Warren's money."
–Bill Gates, after accepting Warren Buffett's $31 billion gift to his foundation

TED BY DEBORAH STEAD

IVACY

EARING HIS ART ON S SLEEVE

JOHN HALAMKA, Harvard lical School's chief rmation officer, nology and privacy are e to the heart. He was ng the first to have a o-frequency ID chip put is arm to help doctors his medical records uld he arrive unconscious n ER. Now the 44-year- s having his genome ienced and will post a of his makeup online, uding clues as to what may one day kill him or make his children predisposed to illness.

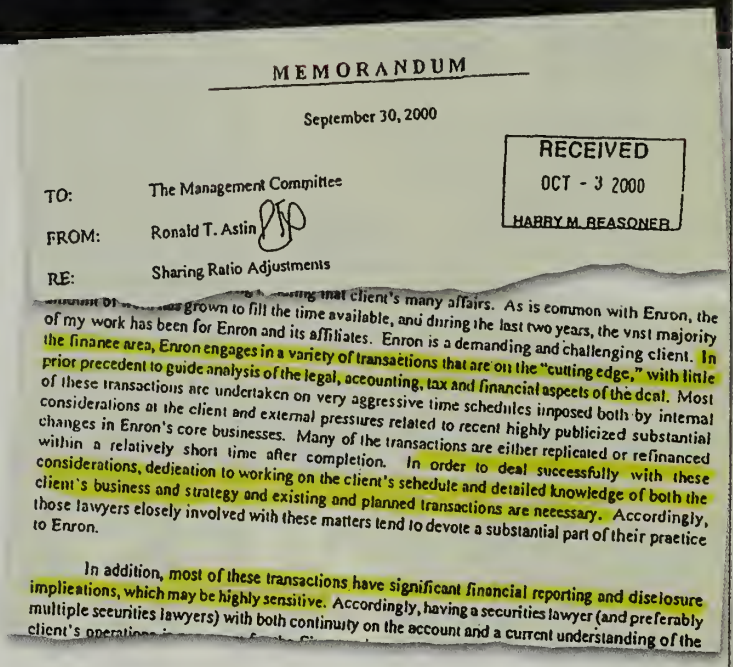
The idea behind these stunts is to start a national conversation about the trade-offs between privacy, quality of care, and cost as medicine gets more high tech. "If in 10 years we'll be carrying around our genome on RFID chips, we have to understand the implications," says Halamka, who chairs a federal standards panel on a proposed electronic National Health Information Network. His own stance: Only patients who agree to it should have their records linked to an e-network. (His ID chip lacks passwords a hacker would need to get his records.) That's different from the "opt-out" provision other experts favor. But Halamka insists that "you only get one chance to get privacy right." Any network, he says, must be trusted by patients and providers alike.
–Timothy J. Mullaney

THE BIG PICTURE

ASSET ANGST The top financial concern of America's wealthiest 1% is that the next generation will have it tougher financially. The very althy, 66% of whom say their estates will be rth more than $5 million, also worry that:

orism will hurt the economy and markets	77%
k market gains will be lower	69%
tion will erode investment gains	67%
s will rise steeply	64%

S Trust Survey of Affluent-Americans XXV, June, 2006



MEMORANDUM

September 30, 2000

RECEIVED
OCT - 3 2000
HARRY M. REASONER

TO: The Management Committee

FROM: Ronald T. Astin

RE: Sharing Ratio Adjustments

...grown to fill the time available, and during the last two years, the vast majority of my work has been for Enron and its affiliates. Enron is a demanding and challenging client. In the finance area, Enron engages in a variety of transactions that are on the "cutting edge," with little prior precedent to guide analysis of the legal, accounting, tax and financial aspects of the deal. Most of these transactions are undertaken on very aggressive time schedules imposed both by internal considerations at the client and external pressures related to recent highly publicized substantial changes in Enron's core businesses. Many of the transactions are either replicated or refinanced within a relatively short time after completion. In order to deal successfully with these considerations, dedication to working on the client's schedule and detailed knowledge of both the client's business and strategy and existing and planned transactions are necessary. Accordingly, those lawyers closely involved with these matters tend to devote a substantial part of their practice to Enron.

In addition, most of these transactions have significant financial reporting and disclosure implications, which may be highly sensitive. Accordingly, having a securities lawyer (and preferably multiple securities lawyers) with both continuity on the account and a current understanding of the client's operations

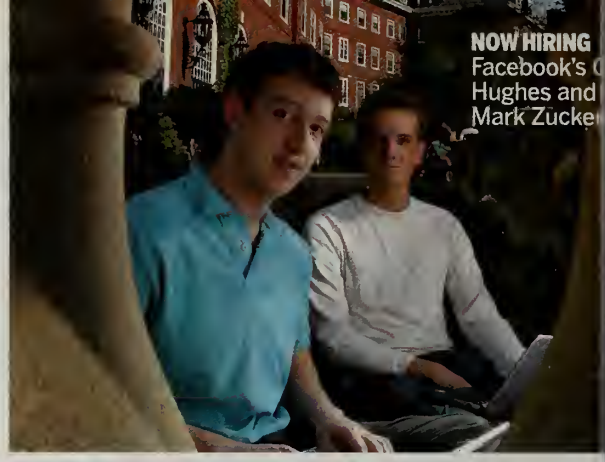
ENRON AFTERMATH

Memo Bites Lawyer

BE CAREFUL what you wish for. In September, 2000, Ronald Astin, a **Vinson & Elkins** partner, sent a memo to the management committee of the giant Houston law firm. Unhappy with his compensation (partners averaged $655,000 that year), he argued that he should get more credit for the work he was doing for a V&E mega-client by the name of **Enron.**

Six years later, some people want to give Astin that credit, in spades: plaintiffs in a class action seeking to hold V&E and others liable for Enron shareholder losses. Part of V&E's defense in the case, now pending in Houston's federal court, is that the firm was little more than a glorified paper pusher for Enron, with no role in shaping the transactions that created the financial house of cards. The plaintiffs, who obtained thousands of V&E documents as part of the suit, are using Astin's memo to argue the opposite. In making his case for more pay, Astin wrote that to handle Enron's work, "detailed knowledge of both the client's business and strategy and existing and planned transactions are necessary." In a June 13 court filing, plaintiffs cite the memo as one of "a Whitman's Sampler" of V&E papers showing that the firm "was present at the creation, active throughout and still in on [Enron's] fraudulent scheme when it finally collapsed." Neither Astin nor V&E responded to requests for comment.
–Michael Orey

UPFront



OFFERINGS

WHERE HAVE ALL THE NEW DEALS GONE?

LAST SUMMER was the hottest season of 2005 for initial public offerings. Some 92 companies raised nearly $15 billion in those three months. But if current activity is any indication, this summer's roster of IPOs will be a quick read. Market researcher **Dealogic** estimates that compared with last June about 17% fewer companies will go public this June, raising 46% less money.

The main culprit: recent volatility in the stock market. Starting as far back as February, a slew of companies have been canceling or postponing IPOs, many citing skittish market conditions as the main reason for their decisions. "If we get past July 4 and we still see IPOs being canceled due to market volatility, we may not see many IPOs again until after Labor Day," says Larry Wieseneck, co-head of global finance at **Lehman Brothers.** In the month of June alone, companies have canceled or postponed nearly $2 billion worth of IPOs, the largest amount of withdrawn IPOs in one month since November, 2004, when $3 billion worth of deals were yanked.

Among the market-related June casualties have been semiconductor producer **Wintegra** (whose IPO was projected to raise $64 million) and **BioNumerik Pharmaceuticals** ($75 million).

–Emily Thornton

GROWNUPS WANTED

FAMOUSLY founded by students for students Facebook gets lots of résumés from recent college grads, says co-founder Chris Hughes At 100 employees and growing, the social networking site seems to be looking way bey the kids in the hall for new hires. "We're now stage in our growth where it's good to have people with some experience and backgrou says marketing director Melanie Deitch. Am current openings: PR manager (minimum of 7 years in corporate communications), direc of inside sales (5 to 10 years in online management), and HR director ("Prior experience leading the HR function for a fast growth company from startup through IPO o successful acquisition"). *–Mark W*

BLOGSPOTTING

WORK, WORK, WORK

www.cenekreport.com

» WHY READ IT For useful, readable posts about new research and trends "in the world of work." Robert Cenek, head of an Iowa-based human resources consultancy, is the self-proclaimed "fad-free" blogger, and he delivers on that promise. No buzzwords. (And he doesn't use the site to flog his own firm.)

For time-strapped HR and management types, here are thumbnail reviews of studies, surveys, and books on, say, the failure rate of small enterprises, the case for conducting longer exit interviews, and "the constellation of factors" that drive job-hopping.

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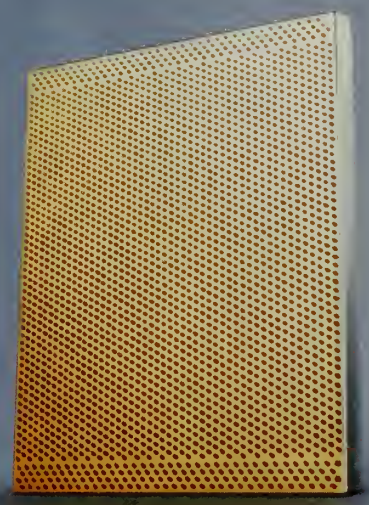

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UPFront

REALTY CHECK

PASS GO AND COLLECT $3.7 MILLION

The real estate boom has hit the Monopoly board. In the update of the London version, the cost of an Oxford Street site has risen 10,000-fold, to about $5.6 million. And that shopping artery is the only location to survive from the 1936 original. Gone is Park Lane in fashionable Mayfair, once the priciest spot, at about $1,600. It has been replaced by Kensington Palace Gardens, reckoned by real estate agents to be Europe's costliest residential address. That site on the board goes for $7.4 million, perhaps a bargain: The street, home to several embassies, is named for the nearby royal residence. A few years ago, steel baron Lakshmi Mittal paid about $130 million for a mansion at Nos. 18-19. For folks who can't absorb such heady numbers (passing Go? See headline), Parker Brothers, the Hasbro unit that owns Monopoly, is still selling the old London version of the game.

–John Templeman

I-WAY PATROL

PLEASE BLOW GENTLY INTO THE PHONE

USING A MOBILE handset to watch digital TV, surf the Net, take photos, listen to music, and pay for train tickets is apparently not enough. Japan's top mobile carrier, NTT DoCoMo, and Tanita Corp. are offering a new service: testing breath samples for alcohol. On June 26, the two began selling a device designed to help trucking, taxi, or bus companies learn if their drivers have been drinking.

To use the $800 device, drivers breathe into an alcohol sensor, developed by Tanita, that connects to DoCoMo's 3G handsets. The result is then beamed to a manager's PC using software downloaded over DoCoMo's network. (If employees have been drinking, the company presumably orders them to stop driving.) There's no point trying to get a friend to breathe into the phone. Using the mobile's live video functions, managers can see on their PCs who is exhaling.

DoCoMo's offering is the only unusual cell-ph gewgaw on the market i Japan. In April, Vodafon Sharp together released handset that recognizes cosmic constellations wh pointed skyward.

–Ian

WEB WATCH

SHOP TILL YOUR AVATAR DROPS

AMERICAN APPAREL, the fast-growing Los Angeles maker of trendy T-shirts and flirty dresses, will throw a grand-opening party in late July at its latest, hippest retail outlet: a computer-generated boutique within the online universe known as Second Life.

The $250 million company is the first real-life retailer doing business in the popular simulation game, in which players negotiate a virtual world through pixel-ated alter egos called avatars, from time to time paying real currency for digitally rendered property, services, and goods.

SECOND LIFE Cyberduds

Just as in real life, the retailer has stirred up controversy. Second Life denizens objecting to its racy real-world ads staged a digital-world protest. Still, ever since American Apparel quietly opened its online outpost a few weeks ago, it has sold about 2,000 digital it according to R Schionning, th chain's Web se director, each or less. "We do intend to mak profit, but ther lot to be learne this arena," sh says. (The com won't say wha paid Linden L Second Life's creator, to ope the shop.)

Schionning American App hiring virtual store clerl part to test-market its n jeans before they appea its shops this fall. And v shoppers will soon get discount at the retailer's stores worldwide.

–Reen

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> "Innovation must... make people's lives happier.... Listening to an iPod, we feel cheerful. Driving a Prius, we feel proud."
>
> *–Yuki Shirato*
> *Tokyo*

ALL REVVED UP ABOUT INNOVATION

CONGRATULATIONS FOR continuing to push the champion-for-innovation envelope (IN Quarterly, June 19). Even before "The innovation economy" (Cover Story, Oct. 11, 2004), *BusinessWeek* has been the foremost voice for "innovation to remain globally competitive" among major publications. Most likely, a future topic in IN will be how to leverage innovation through outsourcing to bring additional creative insights from outside the company. Many businesses are doing this right now. But if a company outsources too many of its high-value-creating functions (research and development, design engineering, product innovation and development, advanced manufacturing, customer communication, etc.), it will damage or lose its ability to develop the tacit knowledge needed to maintain its innovative capabilities within the company. I hope this will also be a topic in a future issue of IN.

–Jim Leonard
Evergreen, Colo.

REGARDLESS OF THE historical discussion of innovation, from Joseph A. Schumpeter's creative destruction Clayton M. Christensen's innova dilemma, the goal of innovation mus simple, i.e., to make people's lives ha er as much as possible. Its outcome is straightforward: Listening to an iPoc feel cheerful. Driving a Prius, we proud. Having Google Inc.'s on-te results, we feel lucky.

Innovation can bloom anywhere necessarily in tech-related fields. Inn tion needs to prosper especially in d oping countries where economic an cial potentialities are still untapped that matter, microfinance originatin Bangladesh is a good example of inn tion that contributes to efficient use sources as well as to poverty reducti

–Yuki Sh
T

SO, INNOVATION is "the new bl ("Introducing IN," Editor's Memo, 19)? Can't you just envision how t going to unfold? First we get a few cles and a couple of books identifyin new class and its stars. Then we'l mention of the innovators who wer novating before it was cool. There w outrageous bidding wars for the to

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:ors. We've already seen some of the ators in B-schools linking up with ners, artists, and other creative . Soon the me-too schools will be ng to catch up. Then comes the clas- gument: Is innovation something an be taught or is it an inborn trait an only be identified and enhanced? eachers and consultants whose very nce relies on the former will insist t can be taught, and they will have tudies to prove it. Real innovators mirk at the prospect and move on.

ve you gotten your organization's e? What about your own personal e? If innovation is the new black, everyone who doesn't have it is go- want to know how to get it, or pre- hey don't need it and then sneak the ltant in after dark to cool them up.

ouple of years there will be a major al when it is discovered that some doctored the results of his HBDI mann Brain Dominance Instru-) assessment when he was younger etween jobs.

at will be followed by some backlash eflection on the whole subject by the its. Best-sellers will include titles as *The Seven Habits of Highly Innov- People; Innovative Dad, Rich Dad; to Great Innovators!;* and, of course, *ne Minute Innovator.*

–Phil Tomlinson
Montoursville, Pa.

T INVESTORS REALLY NEED IS STOMER-SATISFACTION INDEX

KEY METRIC in any business has to tomer satisfaction ("Satisfaction not nteed," News: Analysis & Com- ury, June 19). It is a predictor of the term earnings and long-term value usiness. For a large company it be- s very complicated to measure and or, but it is crucial to do so. Even crucial is the ability to diagnose a ng customer-satisfaction index and prescribe effective solutions.

ga-retailers such as Home Depot ave learned that cutting costs also ustomer benefits, which damages y and ultimately causes the loss of ners. The same has happened at nc.: The company has focused on so intensively that it lost its focus on stomer experience.

ish *BusinessWeek* would post more ner-satisfaction information, which redictive indicator of a company's value. It would be very useful to eaders.

–Thomas E. Bayer, CPA
Springfield, Ill.

SERVICE ISN'T everything, but in the long run, when it comes to customer retention, it's just about everything.

J. Alan Day
Fairfax, Vt.

BIG PHARMA'S 'NURSE EDUCATORS' WALK A FINE LINE

IT'S SYMPTOMATIC of our failing healthcare system that Big Pharma has joined the medical service industry ("Big Pharma's nurse will see you now," Science & Technology, June 12). In doing so, companies walk a fine ethical line between care for patients and care for shareholders. The nurses are clearly providing a valuable and, perhaps, necessary service to both patients and physicians. The argument that these nurses make physicians' jobs easier is similar to the assertion that drug reps do the same—neither is necessarily true if our physicians prescribe according to the best medical evidence available.

Still, it is certainly preferable to see drug companies spend money on patients rather than physicians. The ethical complications of the latter scenario are numerous. Physicians must take care to understand the effects these marketing practices have on their prescribing practices.

–Justin Sanders
Burlington, Vt.

CORRECTIONS & CLARIFICATIONS

A chart accompanying "Back in action" (Personal Finance, June 26) should have listed mutual fund assets in trillions of dollars, not billions.

In "Satisfaction not guaranteed" (News: Analysis & Commentary, June 19), 1% of Home Depot Inc.'s 13 billion transactions is 13 million, not 1.3 million.

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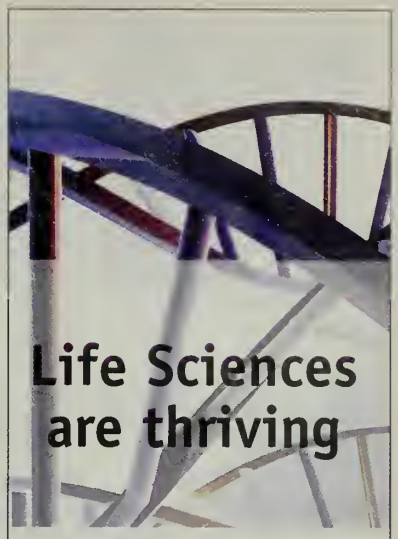

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Technology&You

BY STEPHEN H. WILDSTROM

Look Out, Microsoft Office

A decade ago, *BusinessWeek* ran a cover story predicting that all software would soon be delivered to consumers over the Web, which was then in it infancy. Like many tech prognostications, this was wildly premature, but may yet prove correct. As simple, serviceable alternatives to Microsoft Office proliferate, it seems as if the era of Web-based software is upon us.

The latest example of this trend is Google Spreadsheets. (You can ask to participate in testing it at spreadsheets.google.com.) It's not going to make anyone give up on Microsoft Excel for financial models, big budgets, or fancy presentations. But two things about it were a pleasant surprise: First, it's a free product that includes most of Excel's basic computational abilities, including dozens of math, statistical, financial, and other functions. Second, despite being Web-based, it looks and feels like a desktop application and performs nearly as well.

There are some serious limitations. It works only when you are online, and by default, Google spreadsheets are stored on Google servers. You won't want to put your sensitive data there. You also can't do charts or graphs or fancy "what if" tables. Printing options are limited and work badly for large spreadsheets. And there's no programming language to automate repetitive tasks. But you can open Excel spreadsheets and save your work as an Excel file. And several people can work on the same spreadsheet, a feature Microsoft offers only as part of a fancy collaborative workgroup system.

EARLIER THIS YEAR, GOOGLE BOUGHT a Web-based word processor called Writely, then took the program offline for some retooling. Over time, it could bundle this in a suite with Spreadsheet, Gmail, Google Calendar, and other programs. If Google does this right, the result will be leaner and easier to use than the bloated Office programs.

You don't need to wait for Google if you want to try out a Web-based writing program. Check out ajaxWrite, at ajaxwrite.com. (Ajax is the name of a freely available software tool for creating interactive Web applications.) AjaxWrite is less polished than Google Spreadsheet, and it runs only in the Firefox browser. On the plus side, it can open and save Word files, and all the information is stored on your computer, not on the Web.

Launched by a company called Ajax 13, this word processor includes perhaps 10% of the features that are in Word. For example, it lacks footnoting and bibliography tools, as well as the ability to track editing changes in a document. But most users are unlikely to miss the 90% that this program leaves out. AjaxWrite is part of a suite that includes a drawing program called ajaxSketch and two programs that are still under development: ajaxXLS, a spreadsheet, and ajaxPPT, a sort of online PowerPoint.

Because it is an industry standard, Ajax is available to anyone who wants to use it. Yahoo! took advantage of this in its new Web mail software that lets you drag and drop appointments and messages, just as a desktop program. Ajax is also the basis for a package of programs and services that Microsoft is bundling under the catchall brand Windows Live (live.com).

All these applications are free, at least for now, and it's not clear how any of them will make money. Somehow, they will have to contribute to the fortunes of their sponsors or they will eventually disappear, like many of the free services invented during the Internet bubble.

Web-based programs have their limitations, but the price is right

Knowing the risks, I'll venture a prediction: This new breed of Web-based applications is going to pose a huge challenge to traditional desktop software. Microsoft Office programs will remain the choice for corporations, schools, and other large institutions where their advanced features are widely used. But for individuals and small businesses, simpler will be better—especially if it's cheap or free. If your demands are modest, these Web applications will be the way to go.

E-mail: techandyou@businessweek

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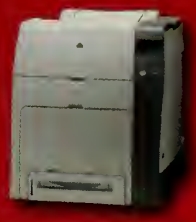

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Alice's Restaurant

ALICE WATERS OWNS only one restaurant and a café, unlike star chef Mario Batali, with his seven. She doesn't have a cooking show on TV, like Bobby Flay. She hasn't created an eponymous line of cookware, like the hyperkinetic Emeril Lagasse. Yet Waters is a legend at the top of the food chain.

Her famous base is Chez Panisse in Berkeley, Calif., where she has championed locally grown organic food and incorporated it into menus aimed squarely at the American palate. Her innovations over nearly four decades have affected not only the restaurant business but the meals Americans crave. Witness Wal-Mart's new push into organic food.

Waters is very much a child of the '60s. Born in Chatham, N.J., in 1944, she attended the University of California, Berkeley, graduating in 1967. Active in the Free Speech movement, she went through the social upheavals of the era side-by-side with Silicon Valley's personal-computer revolutionaries. (She catered Steve Jobs's 50th birthday party last year.) The movement left her with a sense of empowerment, she says. "You felt like if you opened a restaurant, people would come. You were free to act on your passion."

Waters' food passion was kindled on her first trip to France, at age 19, when she was a junior in college majoring in French cultural studies. She wandered the markets of Paris, marveling at produce brought in fresh from the countryside. Nothing wrapped in plastic. Nothing trucked from far away. "It was an epiphany, people really eating something right out of the ground," she says. "It's not just food, but a way of life."

Chez Panisse opened in 1971 with money Waters borrowed from her father and a favorable lease with an option to buy. It failed to turn a profit for the first eight years, but people loaned her money to pay the bills. She developed a network of local organic farmers and created her hallmark seasonal menus, leading to a series of eight cookbooks. The list of chefs who worked for her and then set up shop elsewhere is long and prestigious, from Judi Rodgers (Zuni Café in San Francisco) to Paul Bertolli (Oakland's Oliveto Cafe & Restaurant).

One of Waters' personal goals is to turn people away from fast food, factory farm products, and bland foods transported thousands of miles. These institutions are cost-competitive but Waters much prefers farmers markets and sustainable agriculture—the careful cultivation of fields to reduce the u of chemical fertilizers and pesticides. These approaches co more, but consumers may be willing to pay to support the l stewards of the land, she says. Then they can better apprec the simple act of sitting at a table, talking about where the food comes from, and discovering the culture that produce

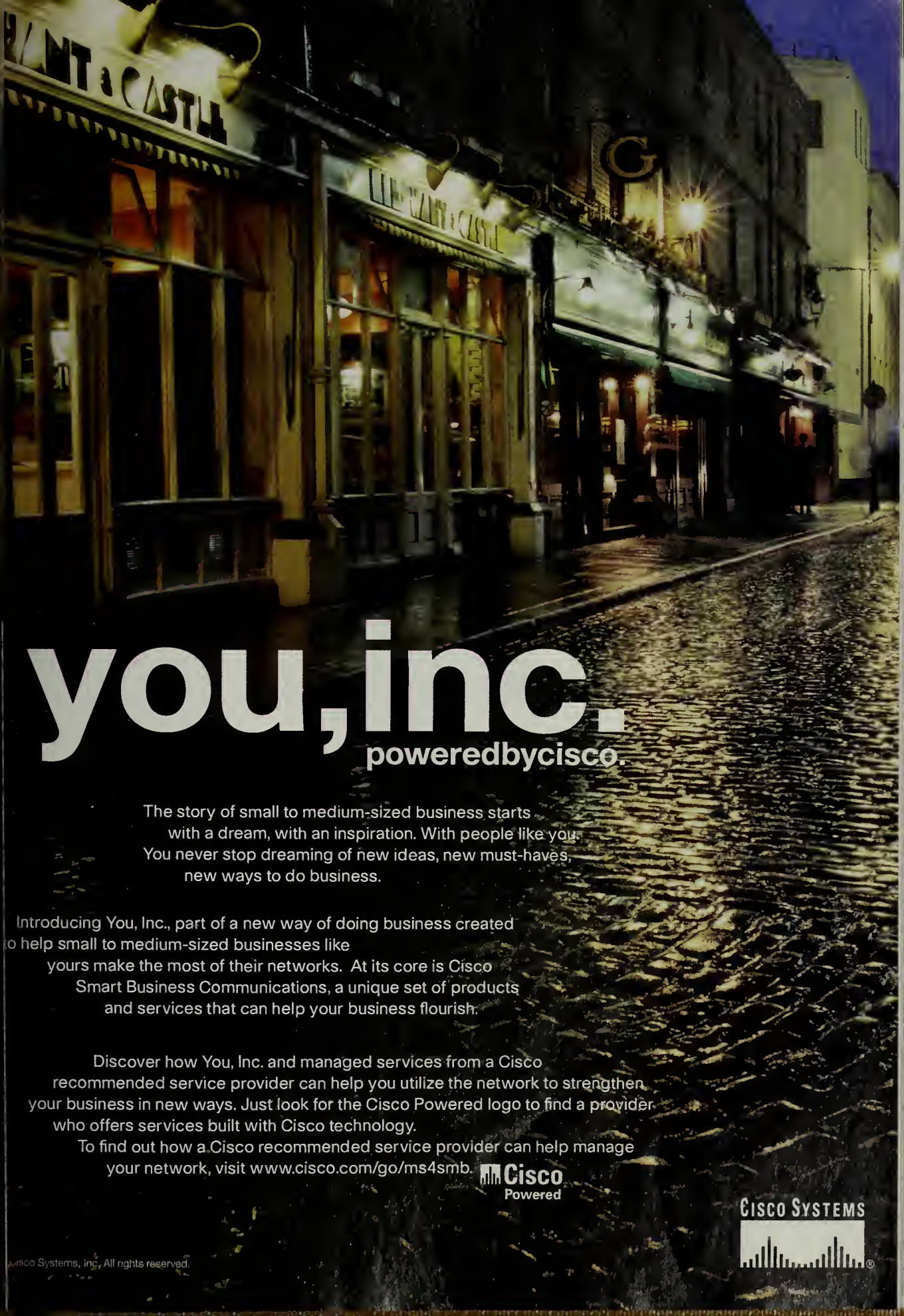
> A champion of organic food for decades, Waters is now having a huge impact

Waters spends plenty of time proselytizin She's a leading voice for the "slow food" movement, a global effort to rescue food cul from the pell-mell pace of Internet-age busir and social interactions. Lately, she has taken "delicious revolution" into schools. Her mos notable experiment is the Edible Schoolyard 1-acre garden and kitchen classroom at Mar Luther King Jr. Middle School, a public scho in Berkeley. Its students, nearly 1,000 of the all take a garden and kitchen class, studying history and anthropology of food, along wit botany and earth sciences.

This is all part of the school's core curriculum, and the movement is now expanding. In leagu with Berkeley, Waters' Chez Panisse Foundation is rolling o similar program to 16 of the city's schools, serving a total of 10,000 children. Part of the agenda is to get kids at risk of obesity consciously engaged with wholesome food. "They li the experience of growing it, picking it, and cooking it," she says. Given the opportunity, adults enjoy the same rituals. A as always, the biggest rewards are in the flavors. Bon appéti

–By Christopher Fa

BusinessWeek online For Christopher Farrell's Q&A with Alice Waters, go to www.businessweek.com/extras



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MediaCentric BY JON FINE

Media, Marketing, and Advertising in the 21st Century

Polluting the Blogosphere

"You can't believe anything you see or read," complains Ted Murphy. "Yo think those judges on *American Idol* want to drink those giant glasses of Coke?" ¶ It's funny to hear him say this because Murphy, who founded a Tampa-based interactive ad agency called MindComet, also runs a side business that pays bloggers to write nice things about corporate

sponsors—without unduly worrying about whether or not bloggers disclose these arrangements to readers. (A scan of relevant blog searches strongly suggests that, often, they don't.)

Murphy is launching PayPerPost.com, which will automate such hookups between advertisers and bloggers and thus codify a new frontier of product placement. Advertisers pay to post details about their "opportunity," specifying, among other things, how they want bloggers to write about, say, a new shoe, if they want photos to be included, and whether they'll pay only for positive mentions. Bloggers who abide by the rules get paid; heavily trafficked blogs may command premium rates. Those seeking to subvert PayPerPost from within can't: No pornographic or "illicit" content is accepted.

Murphy's approach used to be more ad hoc. He made invitations through e-mail via the BlogStar Network, which he started in 2004. BlogStar paid nicely—a flat fee of $5 or $10 per post. "Easy money…go buy a burger or something," advised a BlogStar invitation from 2005 soliciting posts about cable network TNT's basketball commercials featuring HBO character Ali G. That come-on also told bloggers "we definitely appreciate more positive posts."

IT'S BETTER FOR A BRAND to get into a blog than to surround it as a banner or text ad, says Murphy. Unlike ads, blog posts live on in search engines and through links from other sites. "A couple thousand" bloggers have participated in Blogstar Network, he says. As for disclosure, "it's up to [bloggers] to be their own morality police," he says.

There are Old Media types who will use PayPerPost to dump on the credibility of all bloggers, and there are bloggers ready to seize on Murphy's point to trash traditional media. I enjoy a rhetorical race to the bottom as much as the next guy, but both views are deluded. The blog world includes the likes of paidContent.org's Rafat Ali, a premier chronicler of next-generation media, and the dim-bulb stoner down the street. Mainstream media includes both the *Washington Post* and *American Idol*. To paraphrase Bill Clinto Credibility is a journey, not a destinatio

But media today is so cynical that you have to come out and say that shilling w out disclosure is a bad idea. Like Murph one BlogStar client shrugs off such concerns. "With a large enough network, yo get a good representation of [bloggers] disclose, who disclose partially, and othe who go another way," says Mike Friedm director of interactive marketing service for Darden Restaurants, who worked wi BlogStar this spring for the 32-location chain Bahama Breeze. Friedman says BlogStar built Web traffic, and stats fro blog tracker Technorati show that ment of Bahama Breeze spiked duri the promotion.

Bloggers are getting paid to push products. Disclosure is optional

Thanks in no small part to bloggers, this is an era of increased media transparency, many shifty dealings between business and editorial sides h been exposed. Recently *The W Street Journal* reported that advertiser-produced video segments have shown up on local news shows. My colleag Eamon Javers unmasked pun whose op-ed page pieces tout initiatives from corporations that paid them. An undisclos PayPerPost placement on a little-seen blog isn't the most egregious thing out there, but it's far from honest. Media be more transparent, but the line between authentic edito and paid placement is still often smeared, and defenders disclosure can feel, like the proverbial buggy whip compa that they're terribly outmoded. Things being what they ar I should mention that no buggy whip association paid me to say that. ■

BusinessWeek online For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia

JAMES C. COOPER

Housing: Where the Market Is Really Headed

e numbers point to a gradual slowdown rather than a sudden crash

U.S. ECONOMY Amid all the ups and downs in the housing data of e, how you feel about the direction of this year's most closely tched economic sector may well depend on which day of the week u check the news. For example, on June 19, builders' sentiment sank an 11-year low, but the next day the government reported that May

sing starts jumped. A week later, numbers showed a in May sales of new homes, the third monthly gain in v, followed the next day by data for May showing a nd consecutive drop in sales of existing homes. t's the real story, and where is housing headed in the nd half?

ooking past all the recent month-to-month noise in umbers, it's clear that demand for both new and ing homes is down from last year's peaks, and that growth rate of prices continues to slow (table). ever, the drop in sales is not as steep as the data had ested earlier in the year. Sales are declining in an rly fashion, not collapsing, and that pattern will most y continue for the rest of the year.

s for prices, the steepest slowdown has been for new le-family homes and existing condominiums and co- areas where speculative activity has been the test. The cool-down in prices of existing homes, of mportance to the vast majority of homeowners, has more gradual. The softening in prices has been e pronounced in recent months, however, and further ing in the second half is almost certain in a market ed with unsold homes.

here's also a new variable in the mix: The Federal rve's apparent intent to push interest rates even er than most analysts had expected earlier this year. e than anything, housing turns on mortgage rates. r pattern has accounted for about 75% of the thly variation in sales of existing homes over the past de. Rates on both fixed- and adjustable-rate gages are sure to climb much higher in coming ths, adding a new risk to the housing outlook for this year.

S EXAMINE THE NEW-HOME MARKET, which is al to the direct impact of the housing slowdown on conomy, since less construction activity and umer spending on home-related items weigh on th. Based on data through May, home construction in econd quarter will subtract from overall growth for rst time since the 2001 recession. If current trends out, that will be the case for the rest of the year, too. les of new single-family homes had fallen off sharply in January and February. Somewhat surprisingly, they recovered much of that loss, with sales rising 4.6% in May, after reported gains in March and April. However, these numbers are highly volatile from month to month, and should be taken with a grain of salt. Government statisticians can say with 90% confidence that May's change from April was between -8.5% and 17.7%, so there is no assurance that May sales didn't actually decline. What's important is that, so far this year, the average of new home sales is down 10.9% from the average during the second half of last year.

THE HOUSING SLOWDOWN SO FAR

	2004	2005	2006*
SALES			
SINGLE FAMILY:			
NEW	10.1%	6.6%	-9.6%
EXISTING	8.8	5.1	-3.7
CONDO/CO-OP	10.8	10.1	-4.9
PRICES			
SINGLE FAMILY:			
NEW	13.8%	7.5%	5.1%
EXISTING	8.1	12.8	8.2
CONDO/CO-OP	16.6	13.7	2.9

*JAN. THRU MAY VS. SAME PERIOD YEAR AGO

Data: U.S. Census Bureau, National Association of Realtors, Global Insight Inc.

Even that number might understate the weakness. Several builders are reporting higher-than-usual cancellations of orders for this time of year, so some of the sales reported by the government may not have been completed.

These are key reasons not to put too much stock in May's 5% rise in housing starts. Builders surveyed in June by the National Association of Home Builders described both current sales and buyer traffic through model homes as the worst in 11 years. Moreover, that 10.9% falloff in sales this year is much faster than the 3.3% decline in starts over the same period. The gap suggests a growing backlog of inventories that will lead to further declines in starts in coming months, as builders work through unsold homes.

INDEED, INVENTORIES of new homes in May were up nearly 24% from a year ago. Through May, the "months supply" of unsold homes—the time required to sell the inventory at the current sales rate—has averaged 5.8 months this year. That reading is the highest for any five-month stretch in almost 10 years.

The inventory buildup is the key factor weighing on new home prices, along with builders' revenues and

profits. Median prices over the first five months of the year are up 5.1% from the same period last year, vs. a 7.5% gain for all of 2005, but price gains have slowed to a crawl in recent months. Builders are offering to help prospective buyers with closing costs and dangling other incentives to move their growing inventories.

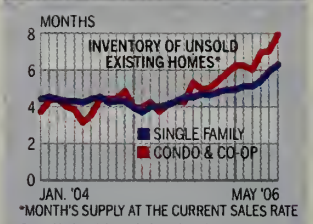
THE HEALTH OF THE MARKET for existing homes is central to housing's indirect effects on economic growth, namely through the impact of home prices on household wealth and the cash homeowners can withdraw from the equity in their homes. So far, so good. This segment has held up better than the new-home market, in terms of both sales and prices. Still, sales have declined in seven of the past nine months, including dips of 2.2% in April and 1.2% in May. Through May, sales of single-family existing homes were down 4% from the average in the second half of last year, while condo and co-op purchases were off 6.7%.

One reason prices of existing homes are holding up better than those of new homes could be that builders are more flexible than homeowners in accepting lower prices. Homeowners are more willing to let their unsold homes sit on the market. Median prices for single-family existing homes are up 8.2% from the same period last year, down from the 12.8% gain for all of 2005.

However, prices are sure to soften further. The main reason: Inventories of existing homes for sale are soaring. By May, they had risen to 3.6 million, up more than a million from a year ago. The months' supply has jumped to 6.5 from 4.3 in May, 2005. The condo and co-op market is especially glutted. While the number of unsc single-family homes has risen 36% from a year ago, th stock of condos and co-ops is up 73%.

Higher mortgage rates will also crimp demand and prices. The average rate on a 30-year fixed mortgage wa 6.7% in late June, up from 5.5% a year ago. However, if Fed pushes its target ra into the 5.5% to 6% ra as many analysts expe fixed-mortgage rates could move close to 7.5 Given that mortgage applications have stop declining in recent we the prospect of higher rates might well be adding some support under demand this spring, as buyers race lock in current rates.

WANT TO BUY A HOME? PLENTY TO PICK FROM



*MONTH'S SUPPLY AT THE CURRENT SALES RATE
Data: National Association of Realtors, Global Insight Inc.

For now, at least, consumers appear to be taking th housing slowdown—and everything else from high ga prices to stock market volatility to rising interest rates in stride. The Conference Board's index of consumer confidence rose one point in June, to 105.7, holding clo to its average for the first half of the year. Buoyant confidence, a solid economy, and firm labor markets a the key reasons that continued softening in housing n dampen, but not severely depress, consumers' overall contribution to economic growth this year.

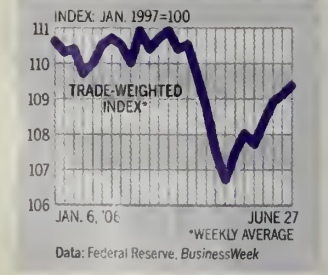
CURRENCIES

A Hawkish Fed and a Rising Dollar

THE U.S. DOLLAR is bouncing back, thanks in large part to the Federal Reserve. The central bank's increasingly hawkish tone has shifted perceptions within the financial markets, which now expect interest rates to keep climbing. And if the Fed follows through, the dollar could pull off another surprising rally, though it probably won't last.

Since the May 10 monetary policy meeting, the Fed's broad trade-weighted index has risen about 3%. The greenback's slide earlier in the year resulted mainly from expectations that the central bank was about to wrap up its two-year-long string of rate hikes while others, such as the European Central Bank and the Bank of Japan, would keep pushing official rates higher.

A LIFT FOR THE GREENBACK



Data: Federal Reserve, *BusinessWeek*

But Chairman Ben Bernanke and other Fed officials are now sounding the inflation alarms. December federal funds futures contracts show that some investors see rates hitting 5.75% before yearend. And a growing number of economists believe the Fed may not stop until 6%, which would widen the spread between U.S. and most foreign rates.

If U.S. rates rise faster than those in the euro zone and Japan, the dollar is likely to keep ticking higher. That would relieve some inflation pressures in the U.S. A stronger dollar would help keep a lid on import prices, which have accelerated. In May, non-energy import prices jumped 0.7% and second-quarter prices a on track to grow by the fastest clip since the first quarter of 2005.

Higher rates and a stronger dol would also stimulate a renewed deterioration in the current accou and trade deficits. Indeed, despite appreciating Chinese yuan, the tr weighted dollar index for other important trading partners—a gr of 19 countries including Mexico, South Korea, and India—is back t where it was at the start of the ye

Longer term, however, mounti deficits will exert downward pres on the dollar. The real concern is the Fed, in its attempt to keep a li inflation, will end up tightening t much. That could result in rate cu next year in response to much slo economic growth, which could precipitate a less than orderly dec in the dollar.

-By James Mehring in New

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The Business Week

News you need to know

EDITED BY HARRY MAURER

Buffett the Beneficent In the most financially magnanimous moment ever, **Warren Buffett** agreed to give away $37 billion to charity. On June 26 he signed documents in New York donating most of that money over some years to the world's biggest philanthropy, the **Bill & Melinda Gates Foundation** (press conference photo, above). The move could double the foundation's size, to $60 billion. That would dwarf the next-largest charity, the Ford Foundation, with a paltry $11 billion in assets.

Buffett, 75, had expected his fortune to be distributed by his wife, Susan, after his death. But she died in 2004. The Gates Foundation will use the windfall to boost its spending on global health and U.S. high school education. **Bill Gates,** 50, professed to be excited but nervous.

ONLINE *See "Warren Buffett's mega-gift," www.businessweek.com/go/tbw*

GM: A Rush to the Exits Union auto workers see the writing on the wall, and it says: "Take a buyout now or be left hanging later." GM said on June 26 that 35,000 of its workers—5,000 more than it hoped for—accepted checks ranging from $35,000 to $140,000 to retire early. Some 12,600 employees at its bankrupt former parts unit, **Delphi,** did the same. The cuts will drop GM's hourly payroll in North America to about 75,000 workers and help ax $5 billion in costs this year.

ONLINE *See "Wagoner's big wins at GM," www.businessweek.com/go/tbw*

Red-Hot Metals It looks as if steel baron **Lakshmi Mitta** going to get what he wants, but he's not getting it cheap. ! lowing a five-month takeover tussle, Luxembourg's **Arc** agreed to merge with **Mittal Steel** on June 25 after Mi upped his offer yet again. The $33.8 billion price tag is 8 more than Arcelor's market value before Mittal fired the f shot in January. Meanwhile, over in the New World, Phoe copper giant **Phelps Dodge** on June 26 tried to wrest Canad mining outfits **Inco** and **Falconbridge** from other contenc for around $35 billion. That fracas may be far from over.

ONLINE *See "What price Mittal's victor www.businessweek.com/go/*

J&J's Big Splurge The titan of **Band-Aids** and baby pow is extending its grip on drugstore shelves. **Johnson & John** said on June 26 that it will buy **Pfizer's** consumer health-c business for a pricey $16.6 billion. The deal gives J&J s powerhouse brands as **Listerine, Visine,** and **Zantac.** Some a lysts worry the purchase will distract J&J, which is tryin heal its medical device business, but it's a winner for Pf which plans to focus on higher-margin prescription dru

Anadarko Makes a Strike Fretting about rising r that could slow growth—and demand for oil and gas al with it—investors have driven down oil-patch stocks in cent weeks, some by 20% or more. Not to worry: **Anad Petroleum CEO Jim Hackett** on June 23 said he plans to f over $21 billion, a rich 40% premium, to buy up two ot energy players, **Kerr-McGee** and **Western Gas Resources.** deals will make Anadarko the biggest U.S. independen

Univision Picks a Buyer It was less auction than g show. After a tumultuous process that saw three priv equity groups bail, Hispanic broadcaster Univision sa will sell itself for $13.7 billion in cash and assumed deb a group including billionaire **Haim Saban.** With two TV works, Univision dominates a fast-growing Hispanic m ket. Jilted bidder **Grupo Televisa,** which owns 11% of Un sion, says it is considering "a number of alternatives." of them, analysts say, might be another bid.

ONLINE *See "Televisa and Univision: Stay tune www.businessweek.com/go/*

Kraft's New Executive Chef It's a homecomin Kraft for **Irene Rosenfeld,** named CEO of the nation's foodmaker on June 26. Her predecessor, **Roger Deron** was ousted. The 53-year-old Rosenfeld, who has hea **PepsiCo** snack division **Frito-Lay** since fall 2004, spent m than 20 years at Kraft before departing three years ago. day, Kraft faces cooling sales and boiling competition. be up to Rosenfeld, known for her marketing chops, t stock the cupboard with innovative creations.

ONLINE *See "At Kraft, a fresh big che www.businessweek.com/go/*

A Black Eye for BP? Oil behemoth **BP** got some gr stains on its carefully cultivated image on June 28, w

Commodity Futures Trading Commission filed a civil com-nt in Chicago alleging that BP traders illegally cor-ed part of the propane market in early 2004, forcing es up briefly and affecting 7 million households. The **ice Dept.** also filed criminal charges in Washington inst a former trader. A BP spokesman says: "Market nipulation did not occur. We are prepared to make and ve that case in the courts." He adds that BP has already en action, "including dismissal of several employees."

lge Fund Watch Is there trouble in hedge fund land? June 23, *The New York Times* reported that the **SEC** is ing into whether **Pequot Capital Management** has traded nside information. The SEC won't comment, and Pe-t says its trading has been entirely proper. On the same in an unrelated case, a federal appeals court tossed out ntroversial rule that would require hedge fund advis-o register with the SEC. The agency says it's studying ptions.

l Americans Buy Smart? The late *Get Smart* actor Adams would have made a great spokesman for nlerChrysler's Smart car, which the company says will ve in the U.S. in early 2008. Smart, best known for its t-foot-long microcar, the two-seater Fortwo, has lost ut $5 billion since its launch in 1998, but **CEO Dieter che** says it will at least break even next year. **United Auto p,** run by **NASCAR** legend **Roger Penske,** will distribute ar, mostly in cities. Marketing will focus on Smart as a gn icon and the notion that it's safe to drive on Ameri-SUV-filled roads.

ONLINE *See "DaimlerChrysler's Smart move," www.businessweek.com/go/tbw*

Payback of the Week

er this one, employers may shift their irritation from ublesome employees to troublesome judges. On June the **Supreme Court** made it easier for workers to make ims involving retaliation. The case involved a female klift operator, **Sheila White,** who filed a sexual harass-ut complaint and then was reassigned to a job with same pay but harder physical la-. After she petitioned the **Equal ployment Opportunity Commission,** was suspended for insubordina-n. Later she was reinstated with k pay, but that didn't soothe the unimous Supremes. Writing the nion in *Burlington Northern and ta Fe Railway v. White,* **Justice hen Breyer** said the company's ons were enough to dissuade a "reasonable worker" n making a claim. Previously, case law had defined liation as largely meaning the loss of a job. Business still take heart, however. The **U.S. Chamber of Com-ce** has claimed victory in 10 of the 13 other high rt cases it weighed in on this year.

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BEHIND THE BUZZ

SO MUCH FANFARE, SO FEW HITS

Rivals get the jitters when Google's nonsearch products grab headlines. But a close look shows that so far, there's not a market leader among them

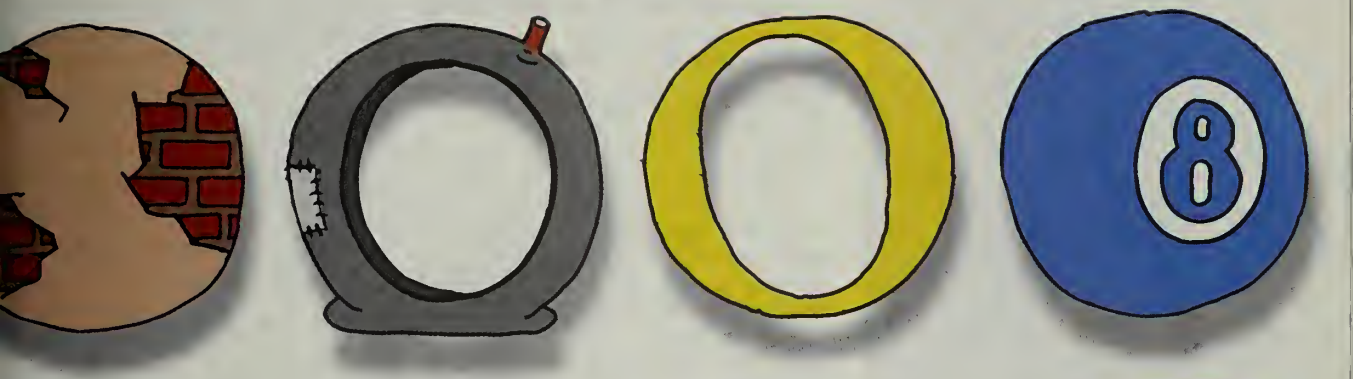
BY BEN ELGIN

IT'S A ROLE ONCE FILLED IBM and later by Microsoft C Today, tech's 800-pound go is Google Inc. A mere mentio one of its executives of a pote new product is enough to s shivers through competitors drive analysts and the press scurryin sift through the ramifications. W Google launched an instant-messag program late last year, tech watc buzzed over the looming confronta with America Online, Yahoo!, and crosoft. Google's launch of on spreadsheet software in June deemed a shot across the bow of crosoft Excel. And when Go prepped for its June 29 debut of Go Checkout, an online payment sys that will compete with eBay Inc.'s Pal, several headlines blared: "Go Readies PayPal-Killer."

But if you cut through the h Google's intimidation factor quickly zles. An analysis of some two dozen ventures launched over the past years shows that Google has yet t tablish a single market leader outsid core search business, where it contin to chew up Microsoft and Yahoo.

Consider just a few exam Google Talk, an instant-messa service launched last August, now r No. 10, garnering just 2% of the nun of users for market leader MSN Mes ger, according to comScore M

O IN THIS SECTION:
Toyota's cars are hits. Why isn't the stock? 32 A legal battle builds over welding 34 Wall Street is steering clear of nuke projects 36 Chinese bloggers go after foreign takeovers



rix. Three-month-old Google Fi-ce, heralded as a competitor to mar-eader Yahoo! Finance, has settled in he 40th-most-visited finance site, rding to data from Hitwise, a com-ive intelligence firm. Gmail, the e- service that was lauded at its 2004 ch for offering 500 times as much ge space as some rivals (they kly closed the gap), today is the sys- of choice for only about one-quarter umber of people who use MSN and o e-mail.

RT ATTENTION SPAN

NOT SURPRISING that as more ces migrate to the Web—from lo-g a restaurant to pricing real estate haring snapshots—the Internet's dominant brand is the presump-winner. But after sparking substan-uzz, most of Google's nonsearch of-gs quickly fade from view. "People Google the victory in the beginning don't show up later to notice that s didn't go anywhere," says Paul S. osky, a venture investor at Ventures Management Inc. "Google has uct ADD. They don't know why re getting into all of these products. have fantastic cash flow but terri-liscipline on products," says Ke-y. "It's a dangerous combination." rtunately for Google, its $120 bil-market valuation is based on its nation in search, a business that is expected to keep growing at 30% to 40% per year. Google has, hands-down, the best algorithms for determining what Web pages to offer up as well as the largest base of advertisers. But many analysts think Google's stock is worth $550 or $600 a share, well above its current $400. That's based on the expectation that more new offerings will take hold. Analysts assume that services such as Google Checkout will generate fees from online transactions. Others, like Google Finance, could bring in more users, offering Google more opportunities to serve up lucrative ads.

But the company's struggles with expansion raise long-term questions about whether it can eventually diversify revenue away from the small text-based ads that now constitute 99% of sales. "This is still a company that derives almost all of its revenues from one business," says Scott Kessler, an analyst at Standard & Poor's.

The problem is that every time Google branches out, it struggles with the very thing that makes its search engine so successful: simplicity. The minimalist Google home page offers a stark contrast with the cluttered sites of key rivals Yahoo and MSN. People go to Google to find information fast. So Google can't showcase its plethora of new products without jeopardizing this sleek interface and the popularity that generates a $6 billion geyser of cash from search ads. But the

MAYER Google expects "to throw out a lot of products"

lack of exposure for its new products means only 10% of Google visitors use it for anything other than Web and image searches, says Hitwise.

It doesn't help that Google, despite its track record for hiring the best and brightest programmers, has a spotty record for new-product quality. Google's philosophy of launching "early and often" frequently leads to products that start out on a par, at best, with those of competitors, giving Internet users little reason to change their surfing habits.

Furthermore, product managers at Google tend to have less power than engineers, say several former staffers. This can contribute to slow product upgrades, since most engineers want to work on the next big launch. Take Orkut, Google's two-year-old social-networking site. Since making an initial splash, Orkut has seen limited changes and has faded in popularity everywhere except Brazil. Today it draws less than 1% as much U.S. traffic as MySpace.

Company officials concede that some of the newer products haven't caught on. But they say a high failure rate is baked into their strategy—as it is for an increasing number of innovative companies (page 42). Marissa Mayer, vice-president for search products and user experience, estimates that up to 60% to 80% of Google's products may eventually crash and burn. But the idea, she says, is to encourage risk-taking and let surviving products truly thrive. "We anticipate that we're going to throw out a lot of products," says Mayer. "But [people] will remember the ones that really matter and the ones that have a lot of user potential."

Case in point: Google Maps, which trails only MapQuest in mapping-site traffic thanks to such innovations as aerial views and "click-and-drag" maps to make navigation easier. The product has become so popular that other outfits build new businesses or services around it, creating "mash-ups" that show things like real-estate listings or crime statistics on top of Google's maps. And four-year-old Google News offers top stories in 40 different countries and languages. That has spurred a jump of over 600% in international usage in the past year, making it the seco most-trafficked news aggregation site

Google's problem isn't a string of f ures, then, but rather the middling p formance of many products that surv In fact, it seems far from achieving ever intended 20% to 40% success ratio. T may be contributing to the internal deb that rages at Google's Mountain V (Calif.) headquarters over how to del more search users to the new products. years, Google has relied on "tabs," the links that sit above its search box and p vide the option to search five different s ices, including images, news, and m There's little agreement, though, over l many tabs should be there and how t should be allocated. "There have been bates since 2001 about how many tabs safe to put on the ho page before you get Yahoo clutter," s Doug Edwards, ex rector for consu marketing, who Google last year.

As the list of Goo products swells, tabs don't do the tr And for most users, s out of tab, out of m Take Google's much alded foray into l searches late last y Many pundits imm ately wrote obituaries the blog-search start that dominated that ner of the Web. "S Technorati/Feedster/ Rocket," said the Go Rumors blog in Sept ber. "The party is ove

Hardly. Users can Google's blog-search only if they click "more" button on home page, which fev As a result, Google's search generates only as much traffic as T norati, says comSc "Google hasn't really an impact at all," Mark Cuban, who he bankroll IceRocket.

One way around tab problem is to p more users to create sonalized home p. around Google's se engine, an option company has offere the past year. A cust

Search for Tomorrow

Google Maps
Google's most innovative nonsearch product, it ranks No. 2 worldwide, but viewership is 20% less than market leader MapQuest's.

Google News
Availability in 40 languages has made it popular worldwide, though less so in the U.S. Ranks No. 2 behind Yahoo! News.

Blog Search
Launched nine months ago, it was expected to bury market-leading Technorati. It gets less than a fifth as many users.

Google Talk
The 10-month-old instant-messaging system ranks No. 10 in the world, with 2% as many users as market leader MSN.

Google Finance
Three months after its launch, the site ranks No. 40 in the U.S. despite wide initial buzz. Yahoo! Finance is No. 1.

Froogle
Despite a link on Google's home page, the shopping search engine is No. 8 in the world, right behind obscure Shop.com.

Orkut
The social-networking site has caught on in Brazil but nowhere else. It gets less than 1% as many U.S. visitors as MySpace.

Gmail
Offered 500 times more storage, but rivals closed the gap. Two-year-old Gmail gets about one-fourth the traffic of Yahoo and MSN.

Google home page can be sur-
ded by information from Google
s headlines, stock quotes, and a list
mails from a Gmail account. True,
pushes people toward a busier
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threshold, including only as many
ons as they wish. Google claims that
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how many are actively in use.

ASURE HUNT

N, THOUGH, Google doesn't make
sy. The "personalized home" link
lick to get started on a customized
e page is all but hidden at the top of
earch page. No wonder most con-
verts to the service so far have been Google's most loyal users rather than the large swath of fickle Web surfers the company hopes to entice. "It's sort of like preaching to the choir," says Forrester Research Inc. analyst Charlene Li.

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Google is tinkering with ways to lift visibility. It co-developed with Sony Pic-
a game for *The Da Vinci Code* to co-
e with the film's May opening. A
of online puzzles required users to
a Google account, which included a
m home page. Google says more
100,000 people completed all 24
es. "[People] got exposed to a lot of
le functionality they wouldn't other-
ave been exposed to," says Mayer.
t even if Google leads users to its
roducts, it needs to add pizzazz and
ve functionality. Most areas it is
ing have entrenched rivals: For
's perusing stock quotes, there's Ya-
Finance. For chat addicts, there's
nstant Messenger. Those services
hat elusive "stickiness" that makes
likely to return—for instance, often
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nance site—which boosts ad values.
th its huge market cap and lead in
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and a culture committed to learn-
om mistakes. And it is collecting a
h of data about what surfers want.
he message coming back so far is
'Google wants to live up to its rep-
n as the beast of Silicon Valley, it
to search harder for products peo-
nt to use. ■

MOTOROLA

TALK IS FINE, BUT...

Handsets are humming as other businesses lag

BY ROGER O. CROCKETT

THERE'S NO DENYING that Motorola Inc. makes some of the hottest phones out there. The RAZR, SLVR, and Q phone are pushing the envelope and forcing rivals into brazen imitation.

Too bad other parts of the company don't throw off quite the same sheen. Admittedly, we're talking about the less exciting pieces of the business, including a division that makes wireless network gear and the broadband unit, which cranks out TV set-top boxes and cable modems. But these two units represent a crucial part of Motorola's long-term strategy to provide the infrastructure for the next generation of gadgetry.

The trouble is that both divisions are growing slowly and cost-cutting their way to profitability. What's more, they face larger rivals with far more resources to toss at new products. So while Motorola also has a $6 billion business selling telecom equipment to the government and corporations, it could find itself overly reliant on the low-margin handset business, which last year generated over half of Motorola's $4.6 billion in net profits. "They're boxed in," says Susan Kalla, of New York investment bank Caris & Co.

Most vexing to Moto watchers is the fact that Chief Executive Edward J. Zander could have shored up the network business by buying another company. Instead rivals are doing the deals. Case in point: the Nokia Corp.-Siemens joint venture, announced June 19, that created a networking equipment behemoth with global scale. Motorola, sitting on a cash pile of more than $10 billion, was sniffing around Siemens, according to sources close to the company, but never acted. Motorola declined to comment, but Zander has said several times that big acquisitions are hard to pull off.

The Euro tieup hurts Motorola because networking equipment looks like a good business. The market for wireless gear will grow from $46.5 billion in global revenue this year to nearly $51.9 billion in 2009, says researcher IDC. But Motorola's $6.3 billion network business pales next to Nokia-Siemens' $16 billion JV. Most analysts expect Motorola's network division to shrink over time. A shame since operating margins are approaching 14% while they're barely 11% in Moto's snazzy phone division.

SQUEEZED

MEANWHILE, Motorola's $2.8 billion broadband unit is suddenly struggling to reach double-digit growth, despite being No. 1 in its market. Because Motorola must make what its cable customers want, there's little room for the kind of cool features that set apart its phones. As a result, its boxes aren't radically different from what everyone else sells, allowing the likes of Comcast Corp. to squeeze the same low prices from Motorola that it gets from upstart overseas rivals. That's why margins were 2% in the first quarter and won't be more than 7% for the year, says Standard & Poor's, like *BusinessWeek* a unit of The McGraw-Hill Companies. It doesn't help that Cisco Systems Inc. last fall gobbled up Scientific Atlanta, Motorola's chief rival in this market, creating another Goliath to contend with.

As Zander huddles with his team to craft strategy, investors remain cautious. Motorola trades at about 15 times 2006 earnings vs. 20 to 22 on average for its peers, according to Citigroup. Zander has done a great job turning around the phone business. Now Wall Street is waiting to see him do the same for the rest of the company. ■

ZANDER The CEO has not made a big deal. Rivals have

Mixed Results

Not everything is going gangbusters

	'05 SALES GROWTH	'06 SALES GROWTH*
Mobile Devices	25.4%	29.5%
Broadband	24.9	8.5
Govt. & Enterprise	5.9	5.6
Networks	5.1	0.9

Data: Deutsche Bank *Est.

INVESTING

THE TOYOTA ENIGMA

With its cars so popular, why are investors neglecting the stock?

2007 TOYOTA CAMRY SE

BY ROBEN FARZAD

PETER LYNCH, FIDELITY Investments' famous fund manager, used to urge people back in the '80s to invest in the companies that dominated their everyday lives. And a current TV ad for an online brokerage shows a mall-bound daughter unwittingly giving her perceptive dad a fashion-stock tip. That "buy what you know" adage hasn't changed.

So why doesn't a lightbulb go off every time Dad starts up his Camry? Toyota Motor Corp. is on pace to be the world's No.1 auto maker by 2008. It produces nearly one of every six cars sold in the U.S., including nine models in the South and Midwest, where it employs 32,000 Americans. Even New York livery cab fleets, once largely made up of leathery Lincolns, now feature Toyota's Prius, the hit hybrid taking coastal cities by storm.

Yet Toyota, which since 1999 has traded as an American depositary receipt on the New York Stock Exchange, is rarely mentioned as an investment in the U.S. Its average daily volume of 370,000 shares is just a fraction of General Motors Corp.'s 13 million and Ford Motor Co.'s 26 million. Although Toyota boasts more than six times the combined market value of GM and Ford, only two U.S. equity analysts cover the stock (table). Toyota's shares, which have soared 70% since their U.S. debut, should be selling themselves. But even after their seven-year rise, they trade at a discount to GM, Ford, and ADR-listed DaimlerChrysler on a price-earnings basis.

While just one little letter separates Toyota's U.S. ticker symbol, TM, from GM, there's a world of difference. For all its brand strength, Toyota largely remains terra incognita to American investors, while GM can still attract buyers even as it flirts with bankruptcy. "Toyota stock doesn't have the 'mind share' of GM or Ford," says John M. Novak, an auto analyst at Chicago's Morningstar Inc. "There's a perception that you can't invest in it [because] it's a Japanese company—that you would require a special account."

Toyota doesn't have the "mind share" of GM or Ford, says an analyst

That perception is wrong, of course. U.S. investors needn't bother selling dollars for yen in the currency market before buying Toyota shares on Japan's Nikkei exchange. Toyota's ADR is dollar-denominated, with each one representing two shares of the Japanese common stock. It's no harder to buy than U.S. shares. Just point and click. (A spokesman says Toyota isn't unknown to U.S. investors, noting that volume has risen steadily over the years.)

Yet, Toyota is an afterthought even among sophisticated institutional investors. Charles K. Bobrinskoy, chairman of Ariel Ca Management, a Chicago v investing shop, essent stumbled upon the stock v he was screening for cor nents for a fund launch year. "We were stunned v Toyota came up," he says. thought it was a typo." started buying at 74 in M 2005; the stock now fet around 100. His theory on it isn't more widely held by institut "It's [Toyota's] cars that are reporte in the U.S., not the earnings—as opp to GM, which is all about earning share and the balance sheet." N agrees: "GM and Ford are constant the news for issues beyond stock formance." Perversely, he says, the r tive attention keeps them on the in ing radars of retail and institut investors alike.

Toyota's trading volume will alwa constrained by foreign companies' e sion from the major U.S. stock ind One high-net-worth wealth manager fesses that he has customized the S dard & Poor's 500-stock index by re ing GM and Ford with Toyota's While that strategy would have perfo far better than an S&P 500 index fund the past seven years, it's complicated with multiple trading commissions pensive. Flattering to Toyota, no d but precisely the kind of move that v never fly on its assembly lines.

Where Is the Love?

MARKET CAPITALIZATION	U.S. AUTO MARKET SHARE (%)	NO. OF U.S. ANALYSTS WHO COVER THE STOCK*
TOYOTA		
$181.3 BILLION	15.9	2
GM		
15.7 BILLION	22.6	18
FORD		
12.2 BILLION	17.3	19

Data: Bloomberg Financial Markets, Edmunds

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TOXIC FUMES Plaintiffs say they can cause nerve damage

LAWSUITS

DOES WELDING MAKE YOU SICK?

Industry won an early round, but a mass tort battle could be brewing

BY LORRAINE WOELLERT

DO FUMES FROM WELDing metal cause nerve damage, and did industry cover up that possible connection? The dispute over these questions is shaping up as the next mass tort battle.

Some 10,000 welders have filed lawsuits in courts around the country in a clash that pits legal veterans of the tobacco and asbestos wars against marquee names from the defense bar. The litigation has spread to some two dozen companies, most of which make welding materials. Others, such as Caterpillar Inc., are distributors of welding supplies, while some inherited and divested small pieces of the market years ago, such as Viacom Inc.

On June 27 the industry won a key early victory when a federal jury found that because welding suppliers had put warnings on their products, they shouldn't be held responsible for a worker's illness. That case, brought by Ernesto G. Solis, 57, a former welder at a Corpus Christi (Tex.) Navy base, is one of about 4,000 claims consolidated in U.S. District Court in Cleveland, and it could influence how others play out. Federal Judge Kathleen M. O'Malley is holding a series of trials—Solis was the first—to establish guidelines for what evidence and legal procedures should be allowed in future cases. While O'Malley's decisions aren't binding, they are likely to be influential.

John Beisner, a lawyer who represented Lincoln Electric Co. and other defendants in the Solis case, says jurors concluded that the product warning labels were a good-faith effort to protect workers. The defense also argued that there isn't conclusive scientific evidence that inhaling welding fumes causes symptoms similar to those of Parkinson's disease, as plaintiffs contend.

Beisner, a partner with O'Melveny & Myers and a leading proponent of reining in mass personal injury suits, sees a broader message: After re revelations of fraudulently generated s involving silica and asbestos, plaint lawyers can no longer count on rounc up batches of allegedly sick worker hopes of scaring companies into settl "The industry has forced them to try ca to put up or shut up," says Beisner.

But the plaintiffs' lawyers, Richar Scruggs and Don Barrett, who led charge against Big Tobacco a decade say the fight is far from over. They are ting that manganese poisoning f welding fumes is a hidden epidemic has caused thousands of workers to come ill with paralyzing tremors. T say they have stronger cases in pipeline concerning plaintiffs with n severe symptoms than Solis, who exh ed a tremor in his right hand.

LOOKING FOR VICTORY

THE PLAINTIFFS' TEAM has amas corporate memos, letters, and mee minutes dating to the 1930s that they show an industry more concerned profits than worker safety. The argun didn't sway the Solis jury. But lawyers they are still uncovering evidence tha companies minimized the risks of w ing even as they provided warnings ginning in the late 1960s.

Welding rods, which are composed steel coated with manganese and c noxious metals, are melted at high he fuse or harden components at consts tion sites, on ships, and in facto Welders wear helmets to shield their from heat and sparks, but that do protect them from toxic fumes. M ganese is linked to tremors and parala but debate persists over what degre exposure causes serious illness.

Welders began suing in the mid-19 Defendants have won cases in courts prior to Scruggs and Barrett ta on the cause. But industry settled the Cleveland test case, paying more $1.6 million. The next case was dism after defendants captured the victi video doing chores he said he couldn't do cause of his tremors.

So far there is scan dence that welding i next asbestos. But Ba says he continues to cover evidence of mis duct. "We have b buster information,' says, while admitting the litigation is gro expensive. "We nee win some verdicts."

THE STAT

10,000

Estimated number of welding cases pending nationwide

Data: *BusinessWeek*

EnvironMentology

Honda thinking in action.

When it comes to talking about the environment, we let our products speak for themselves. In 1974, Honda introduced the ingeniously simple Civic CVCC. World-changing for its fuel efficiency and low emissions, the CVCC demonstrated our spirited commitment to environmentally responsible technology. Many other firsts were to follow, such as the first hybrid vehicle sold in North America and the first government-certified fuel-cell car. This legacy of innovation and acting on our beliefs is what we call our Environmentology. And it's seen in every Honda product, like the 2006 50-mpg* Civic Hybrid.

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ENERGY

NUCLEAR POWER'S MISSING FUEL

Why Wall Street is skeptical of backing a new round of proposed nuke plants

BY ADAM ASTON

NUCLEAR POWER IS hot. Sixteen utilities have expressed intentions to build up to 25 new reactors across the U.S. Just last month, NRG Energy Inc. in Princeton, N.J., unveiled plans to invest $5.2 billion in two new reactors at an existing atomic plant near Houston.

It's a nuclear renaissance, right? Not yet. While smart money is placing multibillion-dollar bets on ethanol, wind power, and solar, it's not throwing buckets of cash at nukes. "The real obstacle isn't the Sierra Club but the 28-year-old analysts on Wall Street," says Bob Simon, Democratic staff director of the Senate Energy and Natural Resources Committee.

Regulators could balk if proposed designs don't meet construction and safety standards. But memories of the delays, titanic cost overruns, and bankruptcies that ended America's love affair with nuclear power in the mid-20th century are the most daunting obstacle. "Investors remain wary of construction risks," says Paul T. Ho, a director at Credit Suisse First Boston's energy group.

That's why, five or so years from now, when the first construction and operating licenses are likely to be granted, only the most creditworthy diversified players, such as Duke Energy and Southern Co., would be likely to dip a toe in these waters, explains Denise Furey, senior director of global power with Fitch Ratings. With their scale, such companies could finance these projects for a decade or so using some combination of debt and equity. But that's a far cry from a new nuclear age.

Historically, utilities did an "abysmal" job controlling building schedules and costs, says David A. Schlissel, an economist at Synapse Energy Economics Inc. in Cambridge, Mass. Between 1975 and 1989, the average period required to complete a plant soared from 5 years to 12. The bill for a group of 75 first-generation plants totaled $224.1 billion (in current dollars), 219% more than estimated, according to a 1986 Energy Dept. study. In time, many utilities collapsed under these debts even as customers' bills soared.

Power companies say they can bring costs down, thanks to new, standardized plant designs and a streamlined, one-step licensing process. "People forget that the construction problems happened 30 years ago. There's been great progress since then," says NRG CEO David Crane. The company plans to use reactors from General Electric Co. and Hitachi Ltd. that have been installed in Japan. This time around, the industry is aiming to build new plants for $1,500 to $2,000 per kilowatt of capacity, compared with a peak, inflation-adjusted cost of about $4,000 in the 1970s.

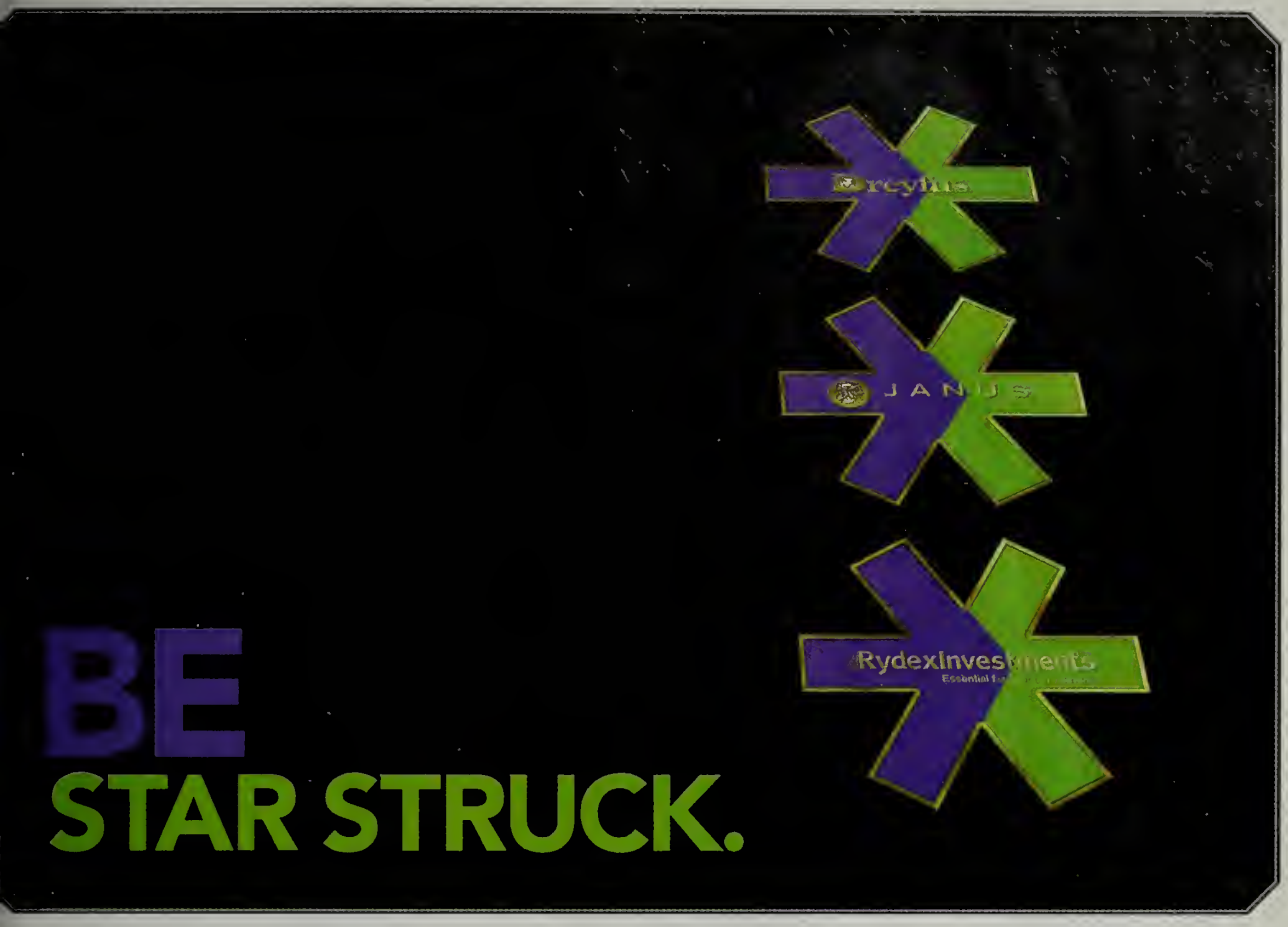
Trouble is, the cheapest plants built recently, all outside the U.S., have cost m than $2,000 per kilowatt. And the vanced designs now on U.S. draw boards have never been built here. "A f of-its-kind facility always costs mo says John Kennedy, a director at Stand & Poor's. "Nukes ought to be part of [energy] mix," says Southern CEO D: M. Ratcliffe, but nobody wants to be to build. "Everyone would actually lik be No. 10," he says.

Utilitie say the can ke costs i check this ti

Last year's Energy Act dangled $13 billion worth of extra treats before the nuclear industry, according to Public Citizen, a consumer-interest group. These are focused on the first six plants and range from some $2 billion set aside to cover construction overruns due to legal challenges to a production tax cr worth up to $5.7 billion. Yet all that may not "provide a sufficient incenti pursue new construction," says Kenn

Energy Secretary Samuel W. Bod offers couched assurances on nukes. convinced we'll get the first six reac with construction starting by 2010. says. "But we don't need six reactors need 16, or 26." Until licenses for t first few plants are granted a few y from now, financiers and many util may just wait to see how the g changes. "Wall Street is very shortsi ed," Furey says. Or maybe it just can't get what it has already seen.

–With John Carey in Washin and Mark Morrison in Austin,



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CHINA

A REVOLT AGAINST FOREIGN TAKEOVERS

Chinese bloggers and businessmen are putting pressure on Beijing to crack down

BY DEXTER ROBERTS

XIANG WENBO IS ON THE warpath. He's angry at the number of Chinese companies falling into foreign hands, and he's using the bully pulpit of the Internet to share his opinions with the rest of China. "We are selling our signature enterprises to foreigners," Xiang wrote on his blog on June 23. "Are we losing our minds?"

Xiang, it must be said, isn't exactly a disinterested observer. His primary beef is a proposed $375 million deal to sell 85% of ailing Xugong Construction Machinery Group Co., China's largest maker of cranes, to Carlyle Group, the well-connected Washington private-equity firm. Xiang is executive president of Sany Group, China's biggest private manufacturer of construction equipment and a rival bidder for Xugong. "In the past we hoped we would get advanced technology from foreign companies, but this never happened," Xiang said in an interview at Sany's headquarters in the steamy southern city of Changsha.

Don't let the fact that Xiang has skin in this game mislead you. His rants reflect a growing sentiment in China. For nearly three decades, Beijing has thrown down the welcome mat for foreigners in hopes of gaining the knowhow to kick-start China's plodding state economy. Now academics, business leaders, and government officials are questioning that strategy. "There should be severe measures to curb and punish hostile takeovers aiming to monopolize the Chinese market," Li Deshui, former head of China's National Bureau of Statistics, told the annual National People's Congress in March.

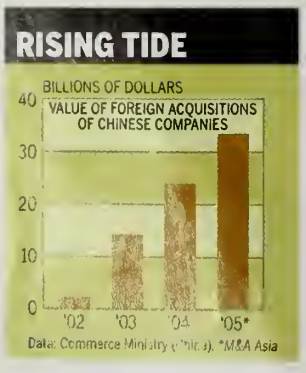
That sort of bluster is starting to spur government action. On June 24, Beijing announced it will set up a commission to combat monopolies, which could hurt overseas companies that have dominant market share. It's also considering new rules that would limit foreign participation in several industrial sectors, and might draw up a list of as many as 30 heavy machinery manufacturers that are off-limits to foreigners. Such regulations could effectively block Carlyle's investment, though b Carlyle and Xugong say they still ex the deal to go through. And to encour the growth of local brands, Beijing is fering low-interest loans to domestic makers and aims to lift the share of nese nameplates to 60% by 2008, from 20% today. "China should not be the world's factory," says Daniel chief investment officer of Geely Auto bile Holdings Ltd., China's No. 2 dome car manufacturer.

It's no surprise that the issue is b raised now. Foreigners such as Coca-C General Motors, Michelin, and Nokia all benefited from policies such as pre ential deals for land and energy, and rates that are about half locals pay. More important eign investors spent $33.4 lion on mainland enterp last year, a 39% increase 2004. "Precisely because t is a surge in activity, voice being raised, asking what consequences are," says Gra Matthews, a partner at P waterhouseCoopers' Trar tion Services in Shanghai.

> "We are selling o signature enterprises to foreigners. Ar we losing our minds?"
>
> –blogger Xiang We

Even with the protectionist rumbl though, foreigners won't likely get boot anytime soon. China is continui open its markets, and Matthews, for says China remains more hospitable Japan or Korea. And on June 4 the *ple's Daily*—the Communist Party's paper—published a strongly worded torial proclaiming that "reform opening up have invigorated China an important choice that determines na's destiny today."

Still, the growing economic nati ism has provided a weapon for the lik Sany as they face off against foreig for acquisitions. "We have to have p over our economy," Xiang says. " then will our economy not be affect factors outside our control."



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AFTER YUKOS

UP AGAINST THE KREMLIN

Khodorkovsky's lawyer isn't laying low as his client sits in a Siberian jail—or as Rosneft goes public

BY DIANE BRADY

PITTED AGAINST THE rough justice of Vladimir Putin's Kremlin, few Russians would think of reaching across the Atlantic for a lawyer who doesn't even speak their language. But when billionaire oil tycoon Mikhail Khodorkovsky faced trial for tax evasion and fraud in 2003—charges many considered politically motivated—he wanted someone to take his case to the world. So Khodorkovsky tapped Robert R. Amsterdam, a Bronx-born litigator now based in Canada, who has built his career defending clients such as Four Seasons Hotels Inc. in political hot spots from Nigeria to Venezuela.

After a highly publicized trial, stoked in part by Amsterdam's bellicose comments on behalf of his client, Khodorkovsky was found guilty in May, 2005, and sentenced to eight years in a Siberian prison camp. The assets of his company, Yukos, were largely absorbed into Rosneft, a state-owned oil giant that's due to go public on July 14. Amsterdam's visa was revoked, and he was booted from Russia immediately after the oligarch's appeal was denied last September—though the Canadian lawyer did stage a press conference before stepping on the plane.

That's not exactly what most would call a success. But for Amsterdam the case is far from closed. He's involved in litigation worldwide related to Khodorkovsky and rails against the treatment of his client, who has since had his face slashed by a fellow inmate and spent several stints in solitary confinement. He has also been criss-crossing the planet as one of the loudest voices opposing the Rosneft flotation. Although Khodorkovsky still pays him, Amsterdam seems to be on a personal mission to spring his client from jail. Some critics such as Eric Kraus, manager of the Nikitsky Russia Fund, say Amsterdam has now "abandoned his role as a lawyer to become a PR agent."

"POWER OF LIFE AND DEATH"

IT'S AN EASY ACCUSATION to lob at the brash, kinetic lawyer. Wherever Amsterdam goes these days, a spotlight is sure to follow. He lobbies the European Union to press for new hearings, speaks at conferences, writes legal papers, and pitches himself to the media. To some, his publicity push is what has kept Khodorkovsky alive. But Amsterdam, 50, knows his strategy carries risks. "We're walking a fine line in angering those who have the power of life and death over [Khodorkovsky]." That doesn't stop him from dubbing Rosneft's acquisition of Yukos' core assets as "state theft" and the IPO as a "syndication of the gulag."

Rosneft supporters obviously dispute

BIO BOX

Robert R. Amsterdam

The activist lawyer fights for clients from Russia to Guatemala

BORN Bronx, N.Y., in January, 1956; moved to Toronto at age 12

JOB Partner, Toronto law firm Amsterdam & Peroff

SPECIALTY Defending clients in tense political environments

YOUTHFUL PASTIMES Traveling in Eastern Europe alone as a teen, trips to hot spots such as Nigeria and Ghana

BEST KNOWN FOR Defending former Yukos oil chief Mikhail Khodorkovsky, now serving an eight-year sentence in Siberia for tax evasion and other charges

EDUCATION Stepfather persuaded Carleton University in Ottawa to admit the dropout at 17; got political science degree at 19 and then a law degree from Queen's University

TIRELESS
Amsterdam's efforts on behalf of Khodorkovsky (right) continue at full tilt

view. Many in Russia argue that dorkovsky essentially stole state as- when he acquired Yukos cheaply ugh a controversial privatization in mid-1990s. But even relatively neutral anders echo some of Amsterdam's erns. George Soros has said he won't h the offer for ethical reasons, and rging-markets guru Mark Mobius is ing away because of legal concerns. s shareholders have already started ie to recoup their losses. And on June ukos—now a much smaller company by a London-based CEO—filed a letter Britain's Financial Services Author- sking that it prevent Rosneft's listing ie London Stock Exchange. "We start the premise that this asset was n," says Yukos spokeswoman Claire dson, noting that the case has received priority status from the European Court of Human Rights. "How can you sell something back to investors that has already been stolen?" Rosneft declined to comment, but finance chief Peter O'Brien recently told an investment conference in Moscow that the company is confident about the outcome of future litigation.

Amsterdam doesn't expect to derail the offering. Even at half the initial planned float, it's expected to raise about $10 billion. With the company valued at anywhere from $60 billion to $80 billion, Amsterdam concedes the prize is too big for investors to pass up. His goal is to put pressure on participants, including banks such as Dresdner Kleinwort Wasserstein and Morgan Stanley, and use the offer to "highlight the deplorable state of human rights and rule of law in Russia." With enough public pressure, he hopes, the Kremlin might release his client. At the very least, he hopes to see the man once said to be Russia's richest citizen moved from Siberia to Moscow.

Amsterdam may not stop the IPO, but he could make many investors think twice

To Amsterdam, few things feel more natural than taking on a politically charged case. When he represented Four Seasons against an owner of its former hotel in Caracas, Venezuela, he managed to have key aspects of the case moved to the U.S., where a court ruled in his client's favor. "He uses the law but brings many other things to bear on the problem," says Randy Weisz, Four Seasons' general counsel. Amsterdam is fighting an even tougher battle in Guatemala, representing entrepreneur Juan Arturo Gutierrez in a civil case against well-connected opponents. That case caught the eye of Khodorkovsky and Guatemala litigators like Walter Robles, who calls Amsterdam "someone who fights the assumption that governments can act with impunity."

He certainly hasn't shown much deference to Russian authorities. Although Russian law doesn't let foreign lawyers argue cases in the courtroom, Amsterdam helped select local attorneys, consulted with Khodorkovsky, and directed the strategy for presenting his case to the outside world. Khodorkovsky's chief defense counsel, Yuri Schmidt, praised Amsterdam's ability to trumpet the cause. "What he said sounded entirely magnificent," says Schmidt, who relied on translators to get Amsterdam's meaning but appreciated his style. Public relations is clearly a key Amsterdam tactic. In a BBC documentary on the trial, he paces, swears, and pontificates while checking his BlackBerry.

INSTINCT FOR FIGHTING

HIS ACTIVIST ROOTS date back to boyhood. After his father died when Amsterdam was six months old, his mother remarried, and the family moved from the Bronx to Ottawa in 1967, when he was 12. The young New Yorker poured his energy into the issues of the day and began traveling through Eastern Europe on trips to accompany his asthmatic mother for treatment. When he got bored with high school, he dropped out, but his stepfather managed to talk Ottawa's Carleton University into accepting him without a diploma. He went on to study at Queen's University law school but spent so little time there that the graduating class gave him a postcard inscribed "wish you were here" at graduation. He then set up shop with classmate Dean A. Peroff in Toronto. The prosperous two-man firm built an expertise in trade disputes and international litigation, with clients ranging from PricewaterhouseCoopers to investors in Nigeria.

If subtlety is part of Amsterdam's arsenal, he hides it well. But he argues that silence rarely achieves results when going up against an authoritarian regime. With his client in Siberia and the Rosneft IPO pushing ahead, his instinct is to fight—loudly. "It's watching impunity that makes you retch," he says. "One of the things I have is a forensic sense. If there's a political fraud, an economic fraud, I will tell you who is screwing who." ■

–With Jason Bush in Moscow

STREAMLINING EXPERTS Tsuru and Hirata reinvented the "mother plant"

JAPAN

NO ONE DOES LEAN LIKE THE JAPANESE

Take Matsushita. To counter low-cost rivals, it's taking efficiency to new heights

BY KENJI HALL

TWO YEARS AGO, Matsushita Electric Industrial Co.'s factory in Saga, on Japan's southern island of Kyushu, was looking mighty lean. The plant had doubled efficiency over the previous four years, and machinery stretching the length of the spotless facility could churn out cordless phones, fax machines, and security cameras in record time.

But Matsushita officials still saw fat that could be trimmed. So the plant's managers, Hitoshi Hirata and Hirofumi Tsuru, ripped out the conveyer belts and replaced them with clusters of robots. New software synchronizes production so each robot is ready to jump into action as soon as the previous step is completed. And if one robot breaks down, the work flow can be shifted to others that do the same job. "It used to be 2 ½ days into a production run before we had our first finished product. But now the first is done in 40 minutes," Hirata says. "Next year we'll try to shorten the cycle even more."

Japan, of course, has long been a global leader in lean production. Japanese companies invented just-in-time manufacturing, where parts arrive at the loading dock right when they're needed. But now, as these companies face increasing competition from low-cost rivals in Korea, China, and elsewhere in Asia, they're working double-time to stay ahead. And to ensure that they produce what consumers are actually buying, they're rearranging factories so they can quickly shift gears to make gadgets that are hot, and ease up on those that are selling more slowly. "The real challenge for a company like Matsush is what I'd call quick in-and-o Get a product there earlier th rivals," says M. Y. Yoshino, a Harv Business School professor who co-thored a case study on Matsushita year. "Then when the low-cost manuf turers come in and try to beat them pricing—get out."

NETWORK HUB

FOR MATSUSHITA, SAGA is at the fo front of that effort. Kunio Nakamura, v on June 28 stepped down from his p tion as Matsushita's president to beco chairman, has often praised Saga as example for the rest of the company a seeks to cut plant inventories in half fr 2004 levels by next March. "To get t most from our manufacturing streng we must lower inventories," Nakam told employees last fall. In his spe Nakamura cited Saga, which now ma a batch of 500 phones per eight-h shift, vs. 1,500 phones in three days fore the most recent changes. While t means Saga can make twice as m phones per week, the company is trimming inventory costs because co ponents such as chips, keypads, and cuit boards spend one-third as much t in the factory.

Those efficiency gains multiply w you look at the big picture. Saga "mother plant," or the hub of an overs manufacturing network. Weeks after rata and Tsuru gave the green light to new layout, six other Matsushita plant China, Malaysia, Mexico, and Bri started copying the setup. Most h since been able to cut their invento and have seen a similar boost in proc tion, today churning out a total 150,000 phones per sh

That's just the kin effort that has hel Matsushita bounce b from a $3.7 billion los 2002. The company Apr. 29 announced best earnings in m than a decade. And in year ending next Ma Matsushita expects profit to increase by 2 to $1.7 billion, on 1% rise in sales, to billion. Matsushita's covery "has much other Japanese elect ics firms can learn fro Morgan Stanley ana

THE STAT

40 minutes

Time from start of production to the first finished gadgets at Matsushita's Saga plant, down from 2½ days before changes

Data: Matsushita Electric Industrial Co.

hiro Ono wrote in a recent report. atsushita itself has learned much Hirata and Tsuru. They dress in ry-issued bamboo-green zip-up ts and indoor-only shoes, and daily they join most of the 280 oyees for calisthenics on the facto- or. But their real focus is on boost- fficiency. Their brainstorming be- two years ago, when they vered that a bottleneck on the as- ly line meant that robots sat idle nger than they were working. So broke the line into stations, or ," that allowed them to double up ower robots to make things flow smoothly.

test runs, the new setup worked, but with so many machines going at once it was tough to choreograph the production process. In the past, a person was assigned to schedule everything from deliveries of supplies to work shifts to maintenance. But that wouldn't fly actory that had to be prepared to gears for a sudden spike or dip in nd. Instead the managers found are that would do the trick.

nveyor ts are t, and sters robots in

next step was figuring out how to the changes globally. With 75 ts to cater to, the seven factories ga's group make 35 million s, faxes, printers, and other prod- nnually. It was a logistical night- There were 1,500 shape and color ions for phones alone, and engi- needed to rearrange as many as 77 -board parts for each new model. ling the robots for every type of was simply too time-consuming, tsushita engineers designed a cir- oard that would need only slight es for each model. Despite the pace, Hirata says defects are at an e low: under 1% in every factory. t's not to say there haven't been speed bumps. For instance, no ctories are the same size, and each a different range of models. So Saga makes changes, it has to ex- ent with new arrangements at plant. "It can take up to three s to get it right, and often we ask cal staff for ideas," says Tsuru. no problem, as long as the s have a good eye for fat.

INDIA

THE MAKING OF A GLOBAL REAL ESTATE GIANT

DLF lured GE and others to India. Now an IPO will give it world stature—and fuel a boom at home

BY MANJEET KRIPALANI

EVER WONDER WHERE the Indians who answer your help desk calls actually sit? Chances are they're in an office complex built by India's most powerful real estate tycoon, Kushal Pal Singh. Among the 74-year-old former army officer's most successful holdings are scores of modern office buildings in Gurgaon, a suburb of New Delhi. His top tenants: back-office tech operations and call centers run by the likes of British Airways, Electronic Data Systems, General Electric, Honeywell, and Nestlé.

HOT TOWN DLF City Centre is part of Gurgaon's modern commercial core

Singh has been tireless in his efforts to lure the globe's biggest corporate players to his buildings. That has helped the developer, whom former General Electric CEO Jack Welch describes as "a true ambassador for India," parlay $1.8 billion in real estate investments into holdings worth about $24 billion. Now, Singh has even bigger ideas for his company, DLF Ltd. He's planning a July initial public offering of 10% of DLF, a deal that could fetch around $2 billion, making it India's largest initial stock offering. The booming Indian economy, says Singh, is creating "a massive opportunity for companies like DLF."

If the IPO on the Bombay Stock Exchange goes off as planned, DLF will rank among the top five global real estate companies. And the deal could make Singh India's richest man, boosting his wealth to some $20 billion. The rise of DLF could also help give birth to a modern real estate industry in India by creating a pool of millions of ordinary investors in a large real estate company, says S. Sriniwasan, who runs the Kotak Realty Fund in Bombay.

HOTELS IN THE WORKS

SINGH, A MASTER dealmaker, served his cause well back in 1989 when he wooed GE's Welch with four days of festivities. The highlight: a warm welcome at the ornate City Palace, the traditional home of the Maharaja of Jaipur. Colorfully dressed riders on elephants greeted Welch's entourage and a huge GE logo made of fresh flowers dominated the front lawn, according to Welch's 2001 autobiography, *Jack: Straight from the Gut*.

That visit set the stage for GE's move six years later into 50,000 square feet in Gurgaon. The deal made the American company DLF's most prominent tenant, helping Singh to land other big fish. Now, with DLF's upcoming public offering, a new round of growth is on the horizon: This year DLF plans to tie up with Hilton Hospitality Inc. to build 100 hotels in India. After that? Singh is hoping for a joint venture in home insurance and would like to sign up a partner such as Walt Disney Co. to develop theme parks.

How Failure Breeds Success

Everyone fears failure. But breakthroug depend on it. The best companies emb their mistakes and learn from them.

BY JENA McGREGOR

EVER HEARD OF CHOGLIT? HOW ABOUT OK SODA OR SURGE? Long after "New Coke" became nearly synonymous with innovation failure, these products joined Coca-Cola Co.'s graveyard of beverage busts.

Choglit, in case you blinked and missed it, was a chocolate-flavored milk drink test-marketed with Nestlé in 2002. OK Soda, unveiled in 1994, tried to capture Generation X with edgy marketing. The "OK Manifesto," parts of which were printed on cans in an attempt at hipster irony, asked: "What's the point of OK Soda?" It turned out customers wondered the same thing. And while Surge did well initially, this me-too Mountain Dew later did anything but. Sales began drying up after five years.

Given that history, failure hardly seems like a subject Chairman and CEO E. Neville Isdell would want to trot out in front of investors. But Isdell did just that, deliberately airing the topic at Coke's annual meeting in April. "You will see some failures," he told the crowd. "As we take more risks, this is something we must accept as part of the regeneration process."

Warning Coke investors that the company might experience some flops is a little like warning Atlantans they might experience afternoon thunderstorms in July. But Isdell thinks it's vital. He wants Coke to take bigger risks, and to do that, he knows he needs to convince employees and shareholders that he will tolerate the failures that will inevitably result. That's the way to change Coke's traditionally risk-averse culture. And en the importance of this goal, there's no podium too bi sending the signal. "Using [the annual meeting] occasion vates the statement to another order of importance," Isdell in an interview with *BusinessWeek*.

CLOSE TO BLASPHEMY

WHILE FEW CEOs are as candid about the potential for fa as Isdell, many are wrestling with the same problem, tryi get their organizations to cozy up to the risk-taking that i vation requires. A warning: It's not going to be an easy shif ter years of cost-cutting initiatives and growing job insec most employees don't exactly feel like putting themselv the line. Add to that the heightened expectations by mar ment on individual performance, and it's easy to see wh many opt to play it safe.

Indeed, for a generation of managers weaned on the rig Six Sigma error-elimination programs, embracing fail gasp!—is close to blasphemy. Stefan H. Thomke, a profes Harvard Business School and author of *Experimentation ters*, says that when he talks to business groups, "I try

provocative and say: 'Failure is not a bad thing.' I always have lots of people staring at me, [thinking] 'Have you lost your mind?' That's O.K. It gets their attention. [Failure] is so important to the experimental process."

That it is. Crucial, in fact. After all, that's why true, breakthrough innovation—an imperative in today's globally competitive world, in which product cycles are shorter than ever—is so extraordinarily hard. It requires well-honed organizations built for efficiency and speed to do what feels unnatural: Explore. Experiment. Foul up, sometimes. Then repeat.

Granted, not all failures are praiseworthy. Some flops are just that: bad ideas. The eVilla, Sony Corp.'s $500 "Internet appliance." The Pontiac Aztek, General Motors Corp.'s ugly duckling "crossover" SUV. For good measure, we'll throw in our own industry's spectacularly useless flop: the CueCat. A marketer's dream, the device, which was launched in 2000 (when else?), scanned bar codes from magazine and newspaper ads, directing readers to Web sites so they wouldn't have to go to the trouble to type in the URL.

But intelligent failures—those that happen early and inexpensively and that contribute new insights about your customers—should be more than just tolerable. They should be encouraged. "Figuring out how to master this process of failing fast and failing cheap and fumbling toward success is probably the most important thing companies have to get good at," says Scott Anthony, the managing director at consulting firm Innosight.

"Getting good" at failure, however, doesn't mean creating anarchy out of organization. It means leaders—not just on a podium at the annual meeting, but in the trenches, every day—who create an environment safe for taking risks and who share stories of their own mistakes. It means bringing in outsiders unattached to a project's past. It means carving out time to reflect on failure, not just success.

Famous Flops

Need inspiration? Many companies have found success in the ashes of their memorable misses:

Xerox

Model A Copier (the "Ox Box"), 1949

The first manually operated xerographic printer, the **Model A** was slow, messy, and hard to use. Businesses were unconvinced and largely stuck with carbon paper. But 10 years later, Xerox launched the fully automated **Model 914,** transforming modern office work.

Ford

Edsel, 1957

Known as the **Titanic of the industry,** this overhyped, oversized, and overpriced car had abysmal sales. Customers even scoffed at the stodgy name. After just over 2,800 of the 1960 models were churned out, the Edsel was history. Chastened, Ford did its research and tuned into customers' call for stylish affordability, launching the legendary **Ford Mustang** in 1964.

McDonald's

Hula Burger, 1962

Founder Ray Kr this cheese-topp pineapple on a Chicagoans who eating meat on But customers a The company le meatless didn't mean wacky, an year a franchise came up with a alternative for hamburger-free the **Filet-O-Fish** McDonald's cla

FAILURE PARTIES

PERHAPS MOST IMPORTANT, it means designing ways to measure performance that balance accountability with the freedom to make mistakes. People may fear failure, but they fear the consequences of it even more. "The performance culture really is in deep conflict with the learning culture," says Paul J. H. Schoemaker, CEO of consulting firm Decision Strategies International Inc. "It's an unusual executive who can balance these."

Some organizations have tried to measure performance in a way that accounts for these opposing pressures. At IBM search, engineers are evaluated on both one- and three-year frames. The one-year term determines the bonus, while three-year period decides rank and salary. The longer frame help neutralize a year of setbacks. "A three-year evaluation sends an important message to our researchers, demonstra our commitment to investing in the early, risky stages of inn tion," says Armando Garcia, vice-president for technical strategy and worldwide operations at IBM Research.

In addition to making sure performance evaluations t long-term view, managers should also think about celebr smart failures. (Those who repeat their mistakes, of co should hardly be rewarded.) Thomas D. Kuczmarski, a Chi new-product development consultant, even proposes "fa parties" as a way of recognizing that it's part of the cre process. "What most companies do is put a wall around a ure as if it's radioactive," says Kuczmarski.

Intuit Inc., based in Mountain View, Calif., recently cele ed an adventurous marketing campaign that failed. The pany had never targeted young tax filers before, and in 2005 it tried to reach them through an ill-fated attempt to

"Most companies...put a wall around a fail

(LISA'S INTERFACE) ROGER RESSMEYER/CORBIS; (NEW COKE) AL FRENI/TIME LIFE PICTURES/GETTY IMAGES; (PFIZER) CHRIS HONDROS/GETTY IMAGES; (KELLOGG'S) SPENCER JONES/STOCKFOOD/GETTY IMAGES; (VIAGRA) DANIEL ACKER/BLOOMBERG NEWS

tax-filing drudgery with hip-hop style. Through a Web site d RockYourRefund.com, Intuit offered young people dis- ts to travel site Expedia Inc. and retailer Best Buy Co. and bility to deposit tax refunds directly into prepaid Visa cards d by hip-hop mogul Russell Simmons.

ıt even hip-hop stars can't make 1040s cool enough to get g adults excited about taxes. "We did very few returns" ıgh the site, says Rick Jensen, vice-president for product agement at Intuit's consumer tax group. "It was almost a ding error." Through a postmortem process, the team that loped the campaign documented its insights, such as the

now finding fans among large companies. Eggers hopes future conferences will feature even more presentations on failures. She also plans to distribute "narrative storytelling booklets" about failed projects so people can "feel the pain."

Unlike Intuit, most companies don't spend enough time and resources looking backward, says Chris Trimble, a professor at the Tuck School of Business at Dartmouth College and co-author of *10 Rules for Strategic Innovators*. That's a mistake. "How do you learn if you don't examine the past?" asks Trimble.

General Electric Co. is trying to do just that. The company, which is well-known for sharing best practices across its many

ght controls
ense for its
ding
while its rival,
its VHS
, Sony faces
mat war, pitting
next-
DVD against
D-DVD. This
nas assembled
adre of
ll it win?

Apple
Lisa, 1983

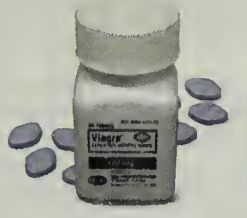
The first commercial personal computer featuring a **graphical user interface (GUI), Lisa** didn't sell because it was sluggish and expensive. But Lisa's GUI helped to inspire Apple's famously user-friendly product line, from the crisp **Macintosh interface of the iMac** to the sleek and simple iPod.

Coca-Cola
New Coke, 1985

Coca-Cola rolled out a well-researched, taste-tested new formula to energize its lethargic brand. But a firestorm of consumer protest led to **New Coke's** demise after 79 days, when the original was brought back with great fanfare. Today, New Coke is a celebrated chapter in Coke lore.

Pfizer
Sildenafil, 1991

First tested on humans in 1991, **Sildenafil** didn't prove effective for its initial indication: angina, or chest pain. After patients reported erections as a side effect, Pfizer began testing the compound for erectile dysfunction. In 1998, **Viagra** became the first drug to treat the condition, and the blockbuster has been a household name ever since.



Kellogg's
Breakfast Mates, 1998

This **cereal-and-milk combo product** was lost on consumers who found the nonrefrigerated milk unappetizing. The inconvenient convenience food was not nearly as appealing as the real thing (above). More mindful of its harried customers' needs, Kellogg has expanded its **line of handy breakfast bars.**

hat Gen Yers don't visit destination Web sites that feel too like advertising. Then, on a stage at the Dolce Hayes ion in San Jose, Calif., last October in front of some 200 marketers, the team received an award from Intuit Chair- Scott Cook. "It's only a failure if we fail to get the learn- says Cook.

addition to postmortems, Intuit has begun plucking in- from its flops through sessions that focus on failure. Eggers, who heads up Intuit's Innovation Lab, held the uch "When Learning Hurts" session recently. There, she nted the story of QuickBase, a software application that for its initial market, small business customers, but is

units, has recently begun formally discussing failures, too. Last September the company set up a two-hour conference call for managers of eight "imagination breakthroughs" that didn't live up to expectations and were being shelved, or "retired," in GE's parlance. ("Imagination breakthroughs"—IBs—are new businesses or products that have potential sales of $100 million within three to five years.)

Such discussions can be nerve-racking, especially in companies where failure has traditionally been met with tough consequences. That was the case at GE, which is now three years into the effort spearheaded by Chairman and CEO Jeffrey R. Immelt to make innovation the new mantra at the $150 billion be-

f it's radioactive," says one consultant

Helen Greiner

–Co-founder and chairman iRobot

My favorite mistake...

When we first started working with the military in the early 1990s, I led the design of an amphibious mine-clearing robot, called Ariel. It walked in the surf and acted like a crab. It was a "12-degree of freedom" walking robot, meaning there are 12 motors to drive 12 joints. At the time, it was the most advanced walking robot in the world. We built technologies that we knew from the labs. But there was a very strong missing component of the user's needs. It couldn't walk far enough, it couldn't carry the payload it would need to carry, and it was too complex.

When we demonstrated Ariel, the reaction was: "iRobot is doing some really innovative and futuristic stuff, but it doesn't solve a current need." It started the perception of our company along a line I wouldn't choose now: We do innovation for innovation's sake. Now I believe the perception of iRobot is we build practical and affordable robots that help people.

After Ariel, I was invited to an Army Rangers demonstration and brought another prototype to solicit input from soldiers. That input led to the design of our PackBot—we've delivered 500 of them so far—a bomb-disposal robot that has been credited with saving the lives of dozens of soldiers. Innovation in our field can lead us in the wrong direction to the most exotic creation. I learned to talk to users and get input before designing. Don't think that you are going to design something that has all c the bells and whistles, then reduce the cost sometime later.

hemoth. "I had some offline conversations with some of the IB leaders reassuring them that this was not a call where they were going to get their pink slips," says Patia McGrath, a GE marketing director who helped put together the call. "The notion of taking big swings, and that it's O.K. to miss the swing, is something that's quite new with Jeff."

Some companies have gone even further, taking a comprehensive look at all their previous failures. That was the ca Corning Inc., which found itself teetering on the brin bankruptcy after the once red-hot market for its optical collapsed during the telecom bust. Following that deb then-Corning CEO James R. Houghton asked Josep Miller Jr., executive vice-president and chief technology cer, to produce an in-depth review of the company's 150-

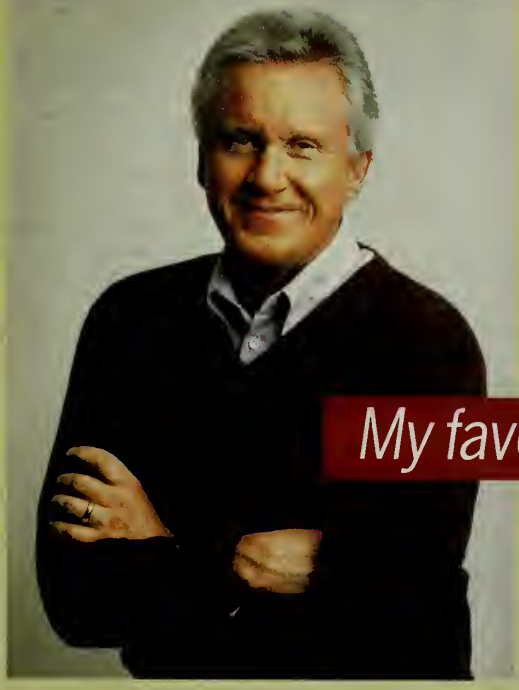
ory of innovation, documenting
failures and successes.
ne of the failed products Corning in-
igated was the DNA microarray, or
, which the company began devel-
g in 1998. Genomics research was
ing up at the time, with Dr. J. Craig
er launching Celera Genomics that
. Corning, which makes laboratory
ices equipment, saw an opportunity.
NA chip was designed to print all
00 human genes onto a set of slides
could be used by researchers. By
), Corning had invested $100 mil-
in the project and announced a
nership with Massachusetts Insti-
of Technology.

E WERE LATE"

WHILE CORNING was trying to
ch the chip, another company,
netrix Inc., commercialized one.
y had the dominant design on
ochips, and they were the first
' says Peter F. Volanakis, now
ing's chief operating officer. "We
late." Quality problems plagued
project, and customers had not
brought in early. With Corning in
efall financially, the DNA chip was
l in 2001.
ill, the experience opened Corning
a whole new market. "We had dis-
ed the marketplace of drug discov-
says Miller. By combining its intro-
on to the drug research market
another failed business, photonics,
h manipulates data using light
s, it created Epic, a revolutionary
ology for drug testing that it will launch this fall. By using
waves instead of fluorescent dyes, Epic promises to accel-
dramatically the process of testing potential drugs and
ove its accuracy.
ne key difference? This time, 18 pharmaceutical companies
tested Epic before the launch. By 2010 to 2012, Jeff
ney, who led Epic's development, projects that Epic sales could reach $100 million to $300 million a year, and more than $500 million annually long-term.

As Corning learned from the DNA chip and with Epic, getting potential users in before a project goes too far helps to prove the market for it. But outside perspectives can also help neutralize emotions and biases about failing product lines, says Duke University Fuqua School of Business professor William

My favorite mistake...



Jeffrey R. Immelt

–Chairman and CEO
General Electric

In 1992, I was running all the commercial operations for the plastics business at GE. We had a product called Nuvel, which was a sheet product that would go over wood to try to create the poor man's Corian countertop. Turns out the thing just didn't work. Any time you dropped a coin on it, it would leave a mark that you couldn't get out unless you buffed it with sandpaper. It was a classic case of just not asking the right questions up front.

This one was my mistake. I let the need for speed overwhelm doing enough up-front market research and testing. It was a $20 million mistake. We caught it after about three months. Customers would complain. At first, you go through this denial phase: "You don't understand" the product and stuff like that.

It made me learn about listening better. I'm more disciplined on the up-front stuff now than I was then. I wanted to do something big and exciting, and I wanted to do it now rather than wait a year. I fessed up: stepped into it, made up for the financial hit we had to take on it [by exceeding sales targets on other products], and made good to the customers. I think that I got better at understanding the need for research and more thought up front, so you don't have to redo things.

You're never allowed in GE to make the same mistake twice. You're allowed to make the mistake once. If you try something and it fails but you went about it the right way and you learned from it, that's not a bad thing.

SHARE YOUR THOUGHTS.

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Sun microsystems | share

Boulding. In research published in the April issue of the *Journal of Marketing*, Boulding and his colleagues contradict the common notion that teams cling to a project because they want to save face or salvage the "sunk costs." Rather, the problem is with the objectivity of the people involved. "Even if you're not on the hook in terms of financial embarrassment or psychological embarrassment," says Boulding, "you did form beliefs, and that causes you to warp new feedback."

That's why W.L. Gore & Associates Inc. in Newark, Del., makers of the waterproof fabric Gore-Tex, recognizes outsiders—people within Gore but not on the product development team—who make the call on projects that need to be pulled. When Brad Jones led Gore's Industrial Products Div., which makes sealants and filtration systems, he handed out "Sharp Shooter" trophies to these outside managers when a project was effectively killed. These marksmen, so to speak, freed from the trappings of familiarity, can identify potential snags that the team may have overlooked. "We're effusive in our thanks for that contribution," says Jones. "We ask them to write up what they learned from it, and how we could have made the decision [to kill the project] faster."

FIND YOUR OWN FLAWS

THE MINDSET THAT Gore looks for in these outsiders—the ability to home in on uncertainties—requires employees to reframe their thinking. Most people naturally seek positive outcomes and set about trying to prove that an experiment works.

But designers, inventors, and scientists, all models for companies struggling to be more creative, take the opposite. They try to prove themselves wrong. That focus on pote flaws makes failure, and the lessons that come with it, ha earlier. Amy Edmondson, a professor at Harvard Business Sc who has studied how organizations learn from failure, says agers would do well to think more like scientists. "Failure vides more 'learning' in a strictly logical or technical sense" success, she says. "It's a principle of the scientific method you can only disconfirm, never confirm, a hypothesis."

Failure's capacity to teach is exactly why venture capit often look for managers to run startups whose résumés in experience with a flop. Gordon McCallum, CEO for Ric Branson's Virgin Management Ltd., can point to mana within Virgin who might have been overlooked by other panies because of failures in their careers. He's also qui

FAILING FORWARD

More Mistakes: In an expanded slide show, more leaders share stories about their failures and what they learned from them

Learning on the Front Lines: How the U.S. Army's after-action review process can help corporations learn from their mistakes

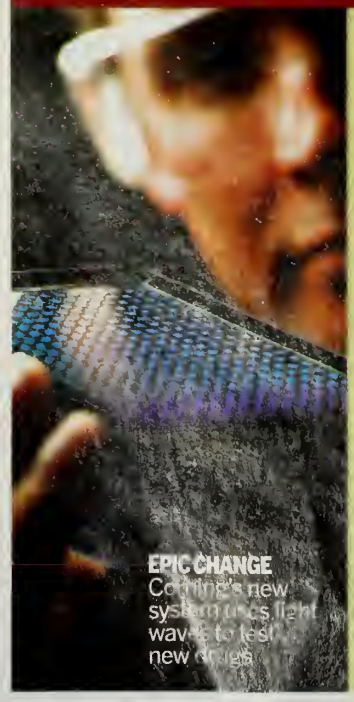
The Story Behind the Story: For a podcast interview with Management Editor Jena McGregor by Executive Editor John A. Byrne, go to **businessweek.com/search/podcasting.htm**

BusinessWeek online
http://www.businessweek.com/extras

PLAYBOOK: BEST-PRACTICE IDEAS

A Formula for Failure

It's innovation's great paradox: Success—that is, true breakthroughs—usually comes through failur How to help your team get comfortable with taking risks and learning from their mistakes.



EPIC CHANGE Corning's new system uses light waves to test new drugs

Formalize Forums For Failure

To keep failures and the valuable lessons they offer from getting swept under the rug, **carve out time for reflection.** GE has recently begun sharing lessons from failures by bringing together managers whose "Imagination Breakthrough" efforts are put on the shelf.

Move The Goalposts

Innovation requires flexibility in meeting goals, since early predictions are often little more than educated guesses. Intuit's Scott Cook even suggests that teams developing new products ignore forecasts in the early days. "For every one of our failures, we had spreadsheets that looked awesome," he says.

Share Personal Stories

If employees hear leaders discussing their own failures, **they'll feel more comfortable talking about their own.** But it's not just the CEO's job—front-line leaders are even more important, says Harvard Business School professor Amy Edmondson. "That person needs to be inviting, curious, and the first to say: 'I made a mistake.' "

Bring In Outsiders

Outsiders can **help neutralize the emotions and biases that prop up a flop.** Customers can be the most valuable. After its DNA chip failed, Corning brought pharma companies in early to test its new drug-discovery technology, Epic.

Prove Yourself Wrong, Not Right

The tendency for development teams is to look for supporting rather than countervailing, evidence. "You have to reframe what you're seeking in the earl days," says Innosight's Scott Anthony. **"You're not really seeking proof that you have t right answer.** It's more about testing to prove yourself wrong

Celebrate Smart Failures

Managers should design performance-management systems that reward risk-takin and foster a long-term view. But they should also **celebrate failures that teach something new,** energizing people to try a and offering them closure.

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ALL SCIENCE. NO FICTION.

nited shown with available equipment. [1]Dynamic Laser Cruise Control was designed to assist the
1 is not a substitute for safe and attentive driving practices. Please see your *Owner's Manual* for
: cautions and instructions. Requires Vehicle Stability Control (VSC). [2]Available on Limited only.
oyota Motor Sales, U.S.A., Inc.

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note that errors on the job, as long as they aren't repeated, are not only supported, but valued.

One example: Virgin Atlantic Airways Ltd.'s J2000 seats, a $67 million investment made in 2000 to create new sleeper seats that reclined at an angle for the airline's "upper-class" seats. Although sleeper seats had long existed in first class, airlines had not yet adopted them for business class. Virgin was the first to announce it would be offering "a bed in business," says Joe Ferry, Virgin's head of design, who led the design of the J2000 seats. Within a year, however, Virgin's idea was one-upped by its chief competitor, British Airways PLC, which rolled out a truly flat bed. While customers were initially enthusiastic about the J2000, some complained about sliding and discomfort. In the end, says McCallum, it "was wildly unsucces: Everybody acknowledged that it was not as good a produc our principal competitors'." Agrees Ferry: "We were an a ran, which didn't really sit well with us."

But Ferry didn't get the ax. In fact, Virgin entrusted hi take on another extraordinary risk, committing a huge $ million to an overhaul of the airline's upper-class seats y before the traditional product life cycle would have en And the company stuck by its investment even after Sept ber 11. The new version, launched in 2003, has been a s success. Called the "upper-class suite," Ferry's make made a design leap beyond merely being flat. Flight at dants flip over the back and seat cushions to make the bec

My favorite mistake

E. Neville Isdell

–Chairman and CEO Coca-Cola

I was [Coke's] division president for Central Europe between '85 and '88. We were doing a restructuring to get 116 bottlers to exchange their equity for ownership in a single bottler in Germany. We took the plan to Atlanta and presented it to the key people we were responsible to and got the support that we needed. We went back and went on a road show around Germany for three days. We reckoned we would get [support] from around 70% of the bottlers, and about 30% would reject us, but that would be enough to get critical mass. End of Day Three, we were celebrating because we had a major bottler, who we thought would not agree, say, "It makes sense."

Then a call came in from the international president—at about 11 o'clock at night—saying: "Stop. You're going to take this offer completely off the table."

What I had underestimated was the degree to which there were multiple constituencies that needed to be covered in order to ensure that the back-door, old relationships that some of the bottlers had built up could not stop us. Phone calls came in to headquarters from bottlers around the world, asking: "What does this mean for me?" I had not thought that through well enough.

I like telling that story because I failed, and the lesson I learned is you have to loc outside the narrow view you have of wher the areas of influence exist. Be sure that you have them all covered. Now I think in different way about where objections mig come from. If you're going to create change, you're going to have people who you're not going to convince. You can neutralize some of them, but I had not done that.

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Seat
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lowing for different foam consistencies for sitting and sleeping. While Ferry hoped the new seats would eventually improve Virgin's business-class market share by 1%, they've already exceeded that goal.

TREMORS AND THRILLS

A COMPANY'S REACTION in the face of intelligent failures, whether it's Virgin reinvesting in a pricey design revamp or Intuit giving an award to its marketing team, can send tremors or thrills through a culture. If top executives are accepting, people will embrace risk. But if managers react harshly, people will retreat from it.

That's something Eric Brinker, JetBlue Airways Corp.'s director of brand management and customer experience, wants to make sure doesn't happen. Last year, JetBlue, which tries to limit its in-flight snack mix to keep costs low and reduce complexity, began hearing that some of its customers wanted a healthier choice. Brinker and his team decided to replace a popular but hardly healthy m Doritos chips called Munchie Mix. "It's the ultimate food," says Brinker.

The junk food fans revolted. "The tribe had spoken, these guys wanted Munchie Mix," Brinker says. "People w really spirited letters, saying: 'This is the only reason I flew Blue!'" Brinker realized he would have to reverse course, bu didn't want his team to think change wasn't encouraged.

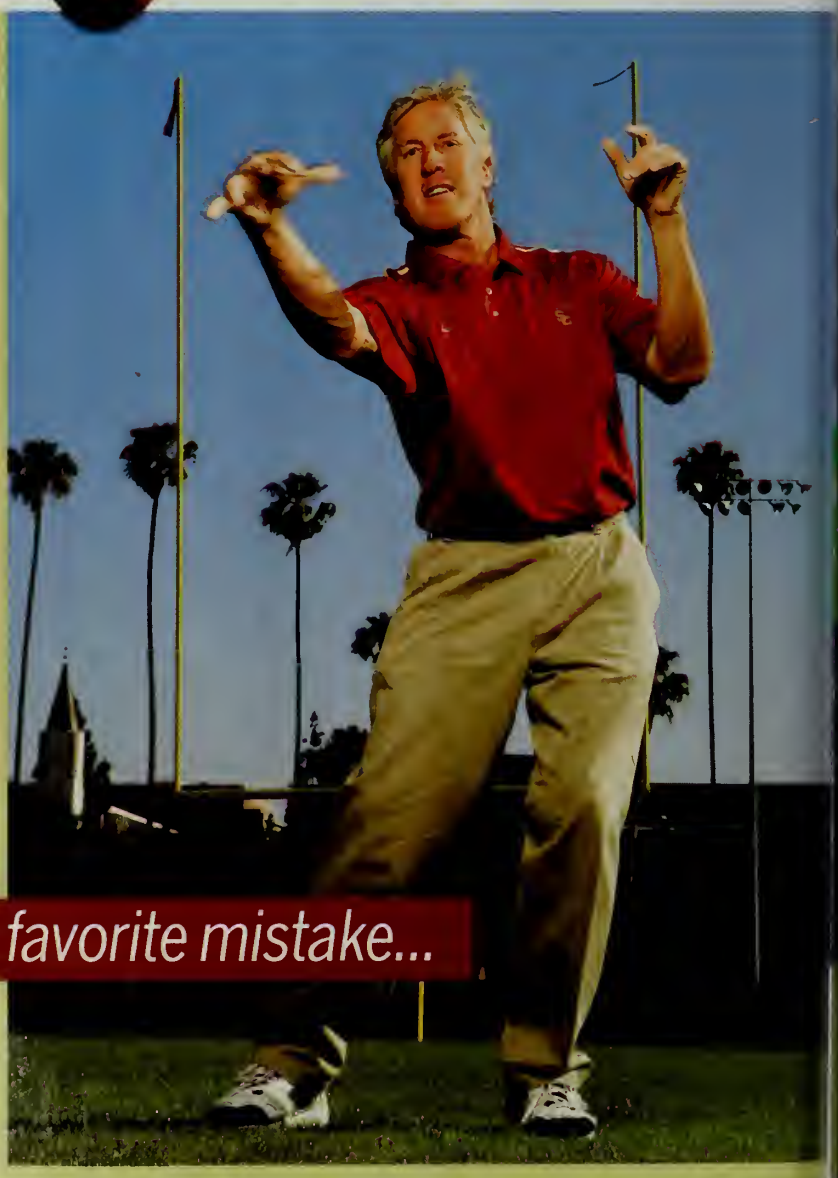
So he decided to make fun of himself to keep the reac lighthearted. On the company's intranet, Brinker started "Save the Munchie Mix" campaign that read: "Some pinl in marketing decided to get rid of the Munchie Mix!" He i ed employees to write in poems and stories about why snack should return to JetBlue. The point? By keeping th fun, he hoped employees wouldn't hesitate to make their creative decisions. "If we don't have people willing to something, then we'll really end up like our competitors." that, of course, would be a failure indeed. ■

–With William C. Symonds in Boston, Dean Foust in Atl and Diane Brady and Moira Herbst in New

My favorite mistake...

Pete Carroll

–Head Football Coach, University of Southern California



When I left my job as defensive coordinator of the San Francisco 49ers, I had two opportunities, at the St. Louis Rams and the New England Patriots. The Rams had had problems, and expectations would be low. On the other hand, the Patriots had just come off losing the Super Bowl. What's more, [former head coach] Bill Parcells had just left the team.

I went to the harder situation. My mistake was not to evaluate the impact of the guy I was following—one of the most heralded coaches in the NFL, a guy with great charisma and great stature. The challenge of it—all the pressure of trying to maintain the program—blinded me to how difficult it would be. Even going 27-21 over three years, I still couldn't keep up with expectations, and I lost my job because we didn't win enough.

I thought I could handle anything. I thought I could follow Bill Parcells. I felt like, Yeah, this'll be good...I'll win them over.

My instincts—to a fault—are always to go to the high-pressure opportunity. I didn't really assess the situation clearly enough. I've learned to really weigh things and not be so driven by my gut. Sometimes it gets us in trouble, that feeling that you can handle anything. You have to dig deeply and not just be emotionally driven into a situation. Great competitors sometimes fall prey to their own drive to see what they can endure.

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Investing in America's Energy Future

As an urban design and planning partner in Chicago for Skidmore, Owings & Merrill, Philip Enquist has focused on the physical, social, and intellectual infrastructure of cities. He strives to create the underlying structure for humane and rational habitats, workplaces, open spaces, and agricultural areas on a rapidly urbanizing planet. In the background is a schematic of Chicago, which has begun to implement one of the world's most ambitious responses to global warming and sustainable living. Two popular symbols of Chicago's sustainability leadership are Millennium Park, which has revitalized the Loop, and the city-wide "green roof" initiative, which is getting strong public and private support.

Green Buildings: Comes the Revolution

Corporate leaders and their architects are aking new initiatives, creating a flourishing narket for the design and construction industry

Majestically situated atop San Francisco's Nob Hill, the Ritz-Carlton Hotel is the epitome of stately elegance. But beneath its pulent furnishings thrums a super-efficient, environmentally orrect PureComfort cooling, heating, and power solution from TC Power. The Ritz-Carlton's managers are certainly forward-inking, but in the building industry today, they're hardly out of ep. From heating and cooling systems to light bulbs to carpet, om cottages to car factories, the great builders of our age — the usiness and industrial communities — are sparking a green evolution that is opening tremendous market opportunities in esign and construction, as much as it is helping to save the planet.

Through efforts large and small, business leaders are address-ig climate change, promoting sustainability, and designing greener ommunities — and, nicely enough, the bottom line for the economy resoundingly positive. Says Mary Shields, president of BP Solar orth America: "Much of the new wave of innovation that is driving owth, relevance, and shareholder value comprises solutions that ill ensure a greener planet and a more sustainable future."

According to Philip Enquist, a partner with Skidmore, Owings Merrill LLP, the architecture, design, and planning firm, "We are ving in an era that is pivoting toward new awareness and actions some fast, but others agonizingly slow." However, while many in e world read and worry about greenhouse gases and global warm-g, a new breed of corporate leadership has stepped up to "own" e challenge and to develop what they hope will one day soon eate zero-energy buildings, or, perhaps, buildings that produce ore power than they consume. The chairmen's letters within this nguard group of green corporations are as likely to inform share-olders about "strategic green and sustainable solutions" and "new ommitments to the environment" as about revenue and profits. his new sensibility is tantamount to a revolution.

---

orty percent of today's carbon missions come from buildings, esidential and commercial.

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ime For Innovation

ruck by the fact that the U.S. is producing nearly a quarter of the carbon dioxide released into the atmosphere, corporate anagement is initiating new leadership actions for U.S. markets, well as internationally. Says BP Solar's Shields: "There are new lutions opening up all around the world for green buildings."

Shields offers up several examples that use solar technology: P and Whole Foods Market, the world's leading organic and

A Letter from Samuel W. Bodman, Secretary of Energy

When examining price trends in natural gas, as well as the pressure to curb electricity demand, it seems that energy efficiency in homes and buildings must sit at the forefront in America's goal for energy independence. Today, residential and commercial buildings consume 39% of total U.S. energy. Buildings alone, account for 53% of our primary consumption of natural gas and 71% of our electricity consumption. It's clear that returns on investment can be remarkable — in savings for today's home-owners and businesses, and in regard to enhanced security and prosperity of future generations.

As part of the Bush Administration's ongoing effort to increase energy and economic security, President Bush announced his Advanced Energy Initiative, which provides a 22% increase in clean-energy research and aims to significantly reduce America's reliance on imported fossil fuels. Achieving goals outlined in this Initiative will ultimately help change the way we build and power our cars, homes, and businesses.

An example of the Department of Energy's recent energy-savings effort includes providing free energy-savings assessments to private sector and federal facilities. These assessments have identified over $165 million in potential savings through 52 assessments, equivalent to the energy used in 240,000 homes.

In partnership with many businesses, like those you will read about in this section, the Department has been creating a new reality for the future of buildings. By 2025, we plan to have marketable net-zero-energy homes and commercial buildings in this country. This reality is being created through thorough research and demonstration that shows how to integrate advances in building structure, equipment, lighting, and windows with progress in solar power, fuel cells, sensors, and controls. All these work to transform America's buildings.

I thank BusinessWeek for highlighting the importance of green building, and for bringing attention to the important activity occurring at the Department of Energy.

Sincerely,

Samuel W. Bodman

Samuel W. Bodman
Secretary of Energy

What's in store for solar?

As part of our goal to double our global manufacturing capacity, we've invested over $25 million in BP Solar's Maryland plant, making it the largest integrated solar panel manufacturing facility in North America. It's a start.

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Commitme to Innovati Drives BP Success

Many companies compete in the alternative energy market, but fe have anything more than limitec tenure developing products or innovative ideas that help suppo sustainable energy practices. Wi more than 30 years of experienc as a leader in the solar industry and an $8 billion commitment tc alternative energy in the next 10 years, BP is clearly different.

Through a broad and deep commitment to supporting ener efficiency and innovative approac to environmental responsibility, BP is shaking things up. "We are an energy company first and for most," says Mary Shields, presid of BP Solar North America. "We concentrate on developing new ideas to meet the world's energy needs and to ensure that we will remain a sustainable business fc the next 50 years and beyond."

To meet those goals, BP has more than doubled its solar bus ness in the last five years and ha aggressive growth plans for the fu Its presence in wind, hydrogen pc and gas-fired power generation markets is also impressive. But t effort to find innovative solutio doesn't end with product devel ment and sales.

Striving to be a good corpor citizen – and a profitable busin – has BP investing in its own in vative energy efficiency initiati

tegrated roof tile products such
s BP Solar's EnergyTile offer an
esthetically pleasing solar option
r home owners.

he company tracks its emissions
more than 300 reporting facili-
es around the world and, over the
st five years, has implemented
ergy projects that now generate
eenhouse gas reductions of 5
illion tons a year, while creating
billion of shareholder value.

Over the next three years, BP
ll assume an even greater leader-
ip role in alternative energies.
hrough a combination of award-
nning product innovations,
w sales approaches, and market
velopment opportunities, BP is
lping to create a world where
lar power is cost-competitive with
ditional electricity. The com-
ny plans to double the size of its
ernative energy business by 2008
and then double it again only
o years later.

"This is a huge business," says
vin Ball, director of energy
iciency for BP. "Growing our
w-carbon businesses and driving
r internal energy efficiency
e how we can best grow our
mpany in a sustainable way,
eate shareholder value, and
duce global emissions."

Solar energy, aisle four.

At more than 250 stores in California, New Jersey and Long Island, BP is teaming with The Home Depot,® the nation's leading home improvement store, to make it easy for homeowners to enjoy the benefits of solar. It's a start.

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Green Building
A $60 Billion New Market

What would you do differently if a $60 billion marketplace suddenly appeared for green products, materials, and infrastructure? Think fast. McGraw-Hill Construction research revealed that green building is becoming mainstream. The market will increase to between 5% and 10% of new construction starts by 2010, or between $29 billion and $59 billion—excluding residential remodeling.

Energy prices and the impact of the built environment on energy consumption and carbon dioxide emissions are driving consumers and building owners. Commercial and residential buildings accounted for more than 35% of U.S. energy use, with office buildings alone spending $24 billion. Commercial green buildings can reduce energy use by 30%, green homes by 30% to 50%. For the green construction industry, that's billions in new opportunities.

McGraw-Hill Construction found that, by early 2007, more homebuilders will be building green than not. But market penetration lags: architects, engineers, and contractors are specifying green products at rates of more than 60%—yet cannot source them. Tremendous opportunity exists. What will you do to meet this need?

Resources for Green Industry Market Research

- GreenSource magazine and Web site **www.greensource.construction.com**
- McGraw-Hill Construction's Commercial and Residential Green Building SmartMarket Reports **www.smartmarket.construction.com**
- Product information **www.products.construction.com**

Harvey M. Bernstein is vice president, industry analytics & alliances, for McGraw-Hill Construction. He co-authored Solving the Innovation Puzzle: Challenges Facing the Design and Construction Industry.

Shenzhen, China, is a major participant in the Green Garden Solar Project.

natural foods supermarket, have worked together to introduce solar energy as a power source for retail energy saving solutions. And the new Green Garden Solar Project in Shenzhen, near Hong Kong, represents a new level of commitment to grid-connected solar solutions. It is one of the most efficient and effective solar energy systems in the world today."

Architects and designers are introducing innovative buildings, products, and specification solutions for the creation of regenerative ecosystems. "The bottom line for business is being redefined," says Jan van Dokkum, president of UTC Power, the South Windsor (CT) division of United Technologies Corp. that supplies environmentally advanced energy solutions for on-site power markets. "The bottom line is multi-dimensional and must include sustainability and corporate responsibility."

UTC Power is the global leader in the development and production of fuel cell and other clean on-site power technologies, as well as the supplier that enabled the Ritz-Carlton in San Francisco to become the first hotel in the world to install the PureComfort combined cooling, heating, and power (CCHP) solution. UTC Power's energy-efficient power solutions are ideal for mitigating rising energy prices while ensuring high-quality, reliable power for the buildings they serve.

The PureComfort system, for example, operates at more than twice the efficiency of the electric grid. These unprecedented efficiencies are achieved by capturing and using exhaust heat to generate additional energy in the form of cold and hot water, which provide cooling and heating. In addition, there are no transmission losses because energy is created right where it's used—on-site.

UTC Power's on-site systems also contribute to a cleaner environment. In fact, over the past 12 months, UTC Power installations at customer sites around the world have collectively reduced NOx emissions equivalent to removing at least 10,000 cars from the roadways and created the same environmental benefits as planting 12,000 acres of forest.

According to Minaz Abji, executive vice president, asset management, for Ritz-Carlton: "The UTC Power solution aligns with the Ritz-Carlton vision to protect the environment as well as to produce bottom-line energy cost savings."

The Real Culprits

Buildings have become a focus for alternative energy solutions for good reason. The number one producer of carbon emissions today isn't vehicles, as most people believe, but buildings. Indeed, an estimated 40% of today's

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carbon emissions come from buildings, residential and commercial. "At the residential level," says Scott Sklar of The Stella Group, a Washington, D.C.-based marketing and policy consulting company, "some 21% of America's global warming pollution is produced by individual households." After commercial and residential, the remaining 40% of carbon emissions comes from the power plants producing the energy themselves.

There are two broad strategies for attacking the inefficiencies inherent in buildings: how they are built and how they operate. Ford Motor Co. is aggressively targeting both. It has already cut carbon emissions in its plants and facilities by more than 15%, with further steep reductions planned. Ford boasts the world's only automotive plant powered entirely by on-site wind turbines, in Dagenham, England, and uses methane gas from landfills at its Wayne assembly plant in Michigan.

The return on investment for companies that paint their buildings green amounts to more than just environmental gold stars. "By integrating energy efficiency technologies and renewable power, buildings will actually produce as much energy as they use, and sometimes even more," asserts David E. Rodgers, program manager of the U.S. Dept. of Energy's building technologies program.

Another sustainability initiator: Trane, the Piscataway (N.J.) unit of American Standard Companies Inc. Trane provides heating, ventilation, and air conditioning (HVAC) systems and services that are environmentally responsible and "good for business."

Its goal, according to President Craig Kissel, is "to put our resources behind helping our customers build green today and tomorrow. We have eight research and design centers around the world with engineering hubs in 21 locations, hundreds of degreed engineers in our global sa force, and more than 70 employees accredited for Leade ship in Energy and Environmental Design through the U Green Buildings Council." The company's customer base includes many international buildings and nearly half th commercial buildings in the U.S.

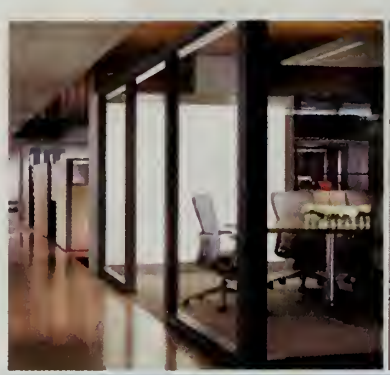
Trane works with its customers to create high-performance buildings that operate at peak energy efficiency ar are environmentally and fiscally responsible, while keepi occupants productive and comfortable.

"We offer high-efficiency system and service options every building type, every application, and every region of the world, including: EarthWise Systems (the most energ efficient large chiller on the market), thermal storage syste geothermal and energy recovery systems, as well as compr hensive building services that ensure performance through the building's life," says Kissel. "We are determined today, and we are steadfast to keep moving in the right direction

Ecological Sensibility

Sustainability isn't just a buzzword. "Actions that accomp sustainability speak to a future economy that can cope wi climate change, establish new energy sources, conserve precious resources, save and manage water, and generate yet new solutions for efficient energy conservation," says UTC Power's van Dokkum.

At heads-up companies, sustainable solutions are bei integrated into building design. Furniture manufacturer



Everybody's Doing It

This Page: Furniture manufacturer Haworth Inc. is committed to transforming its own corporate headquarters and workspaces into sustainable and environmentally sound offices.

Opposite Page: Companies like INVISTA are taking measures, such as recycling old carpet for use in other building materials, in order to keep up with the demand for sustainability in the field of building and manufacturing.

aworth Inc., for instance, is working with architects Ralph ohnson and Eva Maddox, from Perkins & Will, to trans-rm its Holland (MI) corporate headquarters into one that green and high-performance, a model workplace of both erformance and responsibility. The total renovation of rporate headquarters "will demonstrate how Haworth oduct lines work together to provide 'adaptable works-ces,'" says President and CEO Franco Bianchi. "Corporate owth and progress need not be at the expense of sustain-ility – quite the opposite."

Consistent with Haworth's commitment to environmental stainability, the project will meet or exceed the require-ents for Leadership in Energy and Environmental Design (LEED) Gold certification, the U.S. Green Building Council (USGBC) standard for energy efficiency. In the U.S., LEED is the most often used model for sustainable building design guidelines. Says Bianchi: "This project is about doing for ourselves what we do for our customers: creating great spaces that foster innovative thinking, adapting cost-effectively to the changing needs of business, and achieving sustainability objectives, including energy management, green transportation, zero waste, and green buildings."

Haworth has just opened a new plant in India designed to achieve LEED Silver, along with developing a new Zody chair and receiving MBDC Gold cradle-to-cradle certification, and Bianchi is passionate about making further progress. "Let's move from a negative energy footprint to neutral – and then to positive – urgently," he says.

A Novel Fuel

New science, new ideas, and new attitudes are regenerating each element of the building industry, and the result is an authentic green treatment. Alan Wolk is president, interiors, of INVISTA, a Koch Industries Inc. company, based in Wichita, that supplies fibers to the design and building industry, including such brands as Stainmaster carpet and Antron carpet fiber. According to Wolk, "Architects, interior designers, and building owners are driving the demand for

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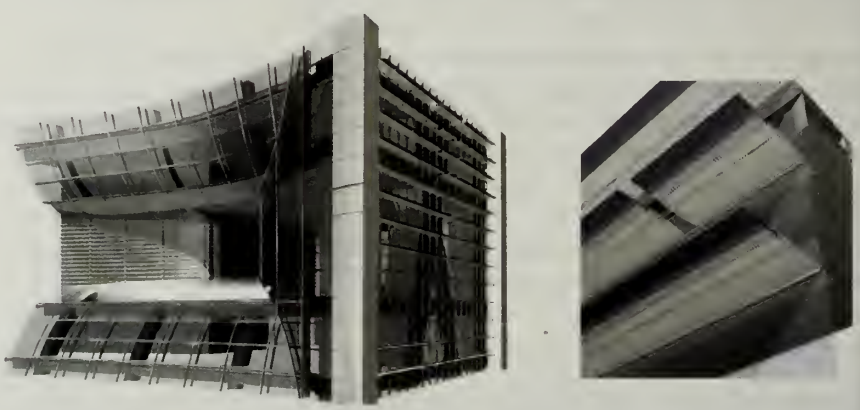
sustainability, exemplified by an interest in recycling or reclaiming old carpet and a consideration for the total environmental impact of a product's entire lifecycle."

INVISTA's plans to reduce its overall environmental footprint include reviewing the total environmental impact of Antron carpet fiber, including key lifecycle evaluations, the most comprehensive measurement of product sustainability. "We've also conducted significant research and invested resources to understand the environmental impact of our manufacturing facilities," says Wolk, "and approximately 36% of the energy consumed in our production facilities comes from 'green energy' sources."

Other INVISTA initiatives: keeping carpet out of landfills and recycling carpet into other valuable products.

Catching Some Rays
As solar panel options are becoming more accessible to commercial and residential customers, designers are considering building aesthetics. Here photovoltaic and perforated panels are integrated into this building exterior.



Now more than 80% of the carpet the company reclaims is recycled into products such as filtration devices, automotive parts, and carpet cushion. The rest is turned into carpet-derived fuel to produce energy that can replace conventional fossil fuels. Says Wolk: "We're proud of the fact that, since 2001, we have been able to divert more than 57 million pounds of carpet from the landfills. We're encouraged that the demand for recycled feedstock continues to grow."

The Green Evolution

A global leader in energy and infrastructure, lighting, building technologies, and water efficiency, Siemens AG is uniquely positioned to observe the impact of today's volatile energy situation — and the importance of sustainable practices. In the facilities sector alone, Siemens' customers range from government entities and military facilities to industrial manufacturers and commercial buildings. All face volatile energy prices and concerns about their long-term energy supply, in addition to aging, inefficient facility infrastructures.

The emergence of sustainability through governmental green building mandates, tax incentives for the private sector, market pressures, and greater customer awareness has propelled the growth of green buildings in both public and private sectors alike. The new reality is that the work environment is an important and expensive piece of the company's operations, requiring just as much scrutiny as machines and materials.

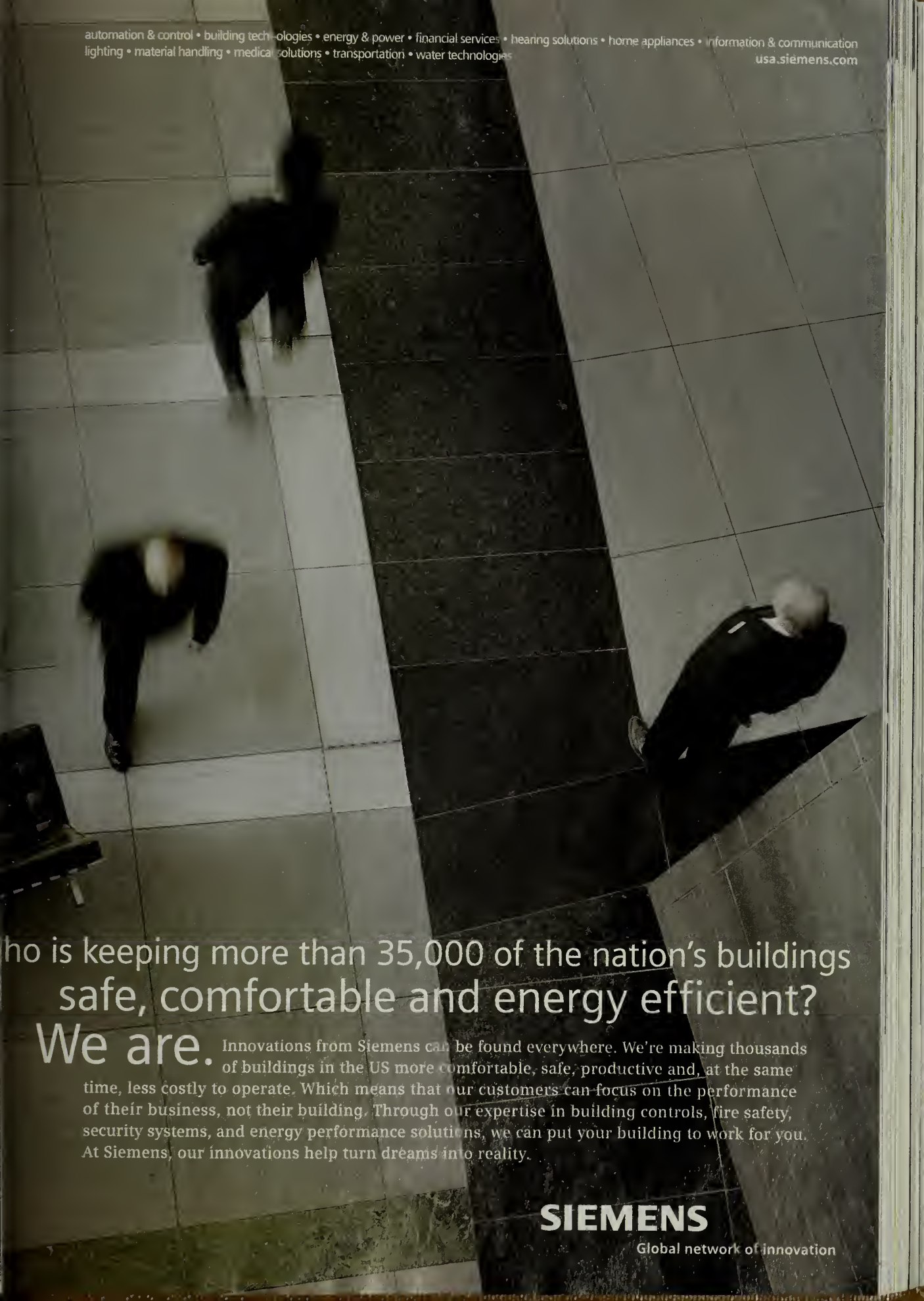
Whether via new construction or retrofitting existing equipment and facilities, business leaders are looking to stabilize their energy costs. Siemens Building Technologies helps customers effectively manage their facilities' energy costs — while having a positive effect on the environment. Solutions range from fully integrated building automation systems to the incorporation of alternative and renewable energy and the implementation of energy-efficient and environmentally conscious facility improvements.

Siemens' business involvement in environmental care extends far beyond its work in the Building Technologies Group. The company has one of the world's broadest energy portfolios, including solutions in waste-to-energy, clean coal, wind and hydro power, emission/pollution control, ethanol plant controls, and hybrid vehicles. In several of its other businesses — water, lighting, transportation, industrial automation, and healthcare — the company also provides solutions that sustain natural resources and contribute to a better quality of life.

Designing With Solar

Alternative energy sources are a cornerstone of green building design, and solar photovoltaics are a promising design element. Solar providers are investing to make solar more accessible for both commercial and residential buildings — whether through retail sales in Home Depot, innovatively financed offers for larger commercial customers, or aesthetically pleasing integrated roof products. Solar solutions are being rolled out for all customer segments.

A recent survey commissioned by Sharp Electronics Corp.'s Solar Energy Solutions Group, in Huntington Beach, Calif., found that of more than 1,000 families, 73% felt that solar energy is more important today than ever. Some 64% said they would pay more for a solar house. "Families are choosing to use solar energy to power their houses, they are choosing to drive hybrid cars, and they're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For Solar Systems, Look to Sharp

These solar panels shade cars from the California sun and are a powerful source of energy.

Earlier this year, a unique 66.6-kilowatt solar electricity system in the form of three custom-built carports was installed in Patagonia Inc.'s parking lot. This innovative marriage of form and function, courtesy of Sharp Electronics Corp.'s Solar Energy Solutions Group, in Huntington Beach, Calif., has become the hallmark of the world's number one solar-cell producer.

With a history in solar energy dating to 1959, Sharp Corp., parent of Sharp Electronics, produces more than 500 MW in solar cells annually, at factories the company is conforming to strict environmental standards. Sharp is a leading manufacturer of complete residential solar electric systems, as well as a top supplier to industrial and municipal markets.

"Sharp's position as the global and U.S. market leader is supported by a corporate commitment to solar energy and strong efforts to expand the business through advanced technology and manufacturing capabilities," says Ron Kenedi, vice president, Sharp Solar Energy Solutions.

For more information please visit http://www.sharpusa.com/solar

SHARP

choosing to put organic clothing on their children," says Ron Kenedi, vice president of the solar solutions unit. "Solar power around the world continues to grow at an annual rate greater than 25%, and the cost difference between solar and regular, utility-supplied power continues to shrink. That heightened awareness toward green energy will spur demand now and in the future."

Transforming Strategies

Other corporate leaders agree. BP, the energy giant – with more than 30 years of experience in the solar market and an $8 billion commitment to alternative energy over the next 10 years – has made BP Solar a major part of its energy strategy. BP Solar has four major manufacturing facilities around the world that employ more than 2,200 people, more than 500 of whom are located in the U.S. office in Frederick, Md.

At BP Solar, designers have integrated solar technology into building components to combine aesthetics with high-tech solutions. At the residenti level, BP Solar offers a product called EnergyTile, a well-camouflaged solar option that's fully built into the roof. The Integra frame, another residential option, is a mere 2 in. high, including the modules that fit into it.

BP is intently pursuing technological breakthroughs in several forms of alternative energy that it hopes will nurture new ecological solutions. "We believe it is important to advance solar, wind, and hydrogen, as well as cleaner natural-gas power options, and we are combining this with an aggre sive internal culture that is focused on conservation and 'living green,'" says Kevin Ball, BP's director of energy efficiency.

"Emissions trading is part of the story for us, of course," says Ball, "but at the heart of BP is a change in attitude and behavior about energy use." BP also supports the search for lower carbon energy alternatives and solution to climate change, recently funding new research at Stanford University, England's Imperial College, the Chinese Academy of Sciences, and Tsinghua University in China.

There's more to solar power than photovoltaics, of course. Solar therm collection systems are proving increasingly popular. The City of Chicago, for instance, recently chose Solargenix Energy LLC, a Raleigh (N.C.) company, to provide thermal collection systems for use in municipal firehouses libraries, and park facilities.

A Bright Idea

In commercial building, the many dimensions and advantages of going green are by now readily apparent to an increasingly sophisticated custome base. In the residential market, by contrast, the case for going green takes o a slightly different cast.

For instance, products as sensible as environmentally efficient lighting are already standard in commercial projects, where architects, engineers, and interior designers are creating and specifying new lighting standards. The next generation of bulbs – compact fluorescent versions – are replaci traditional incandescent bulbs, because they emit high-quality light using a fraction of the electricity.

But their advantage isn't just a function of large-scale deployment. In residential use, they also make a dramatic point regarding conservation: if every household replaced just three 60W incandescent light bulbs with cor pact fluorescent bulbs, the reduction in pollution would equal that of takin 3.5 million cars off the roads. The new bulbs last 15 times longer than the o ones, while significantly lowering electric bills.

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Trane Does HVAC The Green Way

Trane is a global provider of indoor comfort systems and comprehensive facility management solutions. Its offerings include energy-efficient heating, ventilating, and air conditioning systems, services, parts support, advanced building controls, and financing solutions. Each Trane system is designed to meet the specific requirements of customers who need heating, cooling, dehumidifying, and air cleaning systems for residential, commercial, institutional, and industrial applications.

Trane's portfolio includes energy-efficient products, systems, and solutions — from equipment to controls, contracting, and services — that enable its customers to "build green," now and in the future. Its EarthWise CenTraVac System is the most energy-efficient, lowest-emission large chiller available today and the only one with a leak-tight guarantee.

Trane is committed to serving its customers' needs through environmental responsibility, considering all factors that contribute to the planet's health — ozone depletion, global warming, indoor air quality, water conservation, recycle/reuse strategies, energy conservation, and noise pollution.

For more information, please visit http://www.trane.com

A popular name in household electronics, Sharp, ha pledged to become a company with zero global-warmin impact by the year 2010. In order to accomplish this, th Japan-headquartered giant plans to make products tha will save consumers as much energy as will be used in their manufacture. R&D is focused on developing "sup green" technologies, products, and services, utilizing sol energy and energy-saving devices such as LCDs and LE

With such contributions from forward-thinking manufacturers, the dream of building zero-energy hom is finally becoming a reality. A leading contributor to the residential construction industry, the American Plastic Council (APC), has also adopted an efficiency paradig with its members. "Highly energy-efficient structures, from floor insulation to efficient radiant heating to entire modular solutions, are a priority," declares APC Director Robert Krebs.

Green Goes to the Bottom Line

"Not long ago, green buildings were regarded as interes ing experiments but unfeasible and impractical in the re business world," says Skidmore's Enquist. Not so today. Defying skepticism that big business can adapt quickly enough to meet the challenges, corporate leaders, alon with their architects, are taking corrective and innovativ actions in an area where they wield enormous clout: the built environment.

"There is increasing urgency to establish new polici new energy-efficient products, and new behaviors that protect the environment," declares BP Solar's Shields. In so doing, business leaders will improve the resilienc of their corporations while strengthening the new mul dimensional — and green — bottom line.

Web Directory

Antron Carpet Fiber
http://antron.net

BP http://www.bp.com

Haworth Inc.
http://www.haworth.com

RenewableEnergyAccess.com
http://www.Renewable
EnergyAccess.com

Sharp Electronics Corp.
http://www.sharpusa.com/solar

Siemens AG
http://www.usa.siemens.c

Skidmore, Owings & Mer
http://www.som.com

Solargenix Energy LLC
http://www.solargenix.co

Trane
http://www.trane.com

UTC Power
http://www.utcpower.com

To visit the Department of Energy's Energy Efficiency and Rene Energy Web site, go to: **www.eere.energy.gov**

For more information on the Department of Energy's Buildin Technologies Program, go to **www.eere.energy.gov/building**

James P. Cramer, writer, is the chairman and principal of Greenw Group, a management consultancy and research firm based in Atla He is co-chair of the Design Futures Council and founder of the Leade Summit on Sustainable Design.

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A Board With Its Back To the Wall

McGUIRE choose t of his op

UnitedHealth directors aren't ready to oust embattled CEO McGuire. Here's why

BY JANE SASSEEN

WHY DOES UNITEDHealth Group CEO William W. McGuire remain in his job? It's a question that has baffled corporate governance experts since *The Wall Street Journal* reported in March that UnitedHealth and other companies might have backdated options grants for officers to boost compensation. In the post-Sarbanes-Oxley world, boards are acting on the first whiffs of legal or ethical lapses. Already 15 executives and directors from the 50 or so companies under investigation for backdating have been forced out. Heck, Raytheon's board even docked CEO William H. Swanson a million bucks in May for plagiarizing passages of his book—not even a criminal offense.

Yet despite shareholder suits, federal and state investigations, a possible earnings restatement, and the disappearance of some $17 billion in market value, UnitedHealth's McGuire remains in his post, sitting on unrealized options gains now worth around $1 billion.

Paul Hodgson, senior research associate at the Corporate Library, a governance tracker, blames a weak board that remains too deferential to its dynamic CEO. But directors have other reasons to let McGuire stay. For one, given his strong leadership—shares soared from a split-adjusted $1 when he began in early 1991 to a high of $64 in December—investors aren't pressing for his ouster. "No one wants to see him dismissed," says David Dreman, chairman and chief investment officer of Dreman Value Management, which recently bought 781,000 shares.

There's another important reason: While boards at companies that have pushed out executives appear not to have known about the alleged backdating, UnitedHealth's board allowed McGuire to pick his options grant dates. To d him would be to admit that some wr doing occurred—a position that coul crease the legal risks for directors th selves. Instead, they're hunkering dc

MULTIPLE INVESTIGATIONS

IT'S A HIGH-RISK strategy. The lc the scandal drags on, the more Un Health's shares are likely to sag. "If put out a release tomorrow saying th sue was resolved and that he was lea the stock would go up," says analyst McDonald of CIBC World Markets I

Neither McGuire nor directors w comment for this story. Probes by the Attorney's Office in New York, the Se ties & Exchange Commission, and th ternal Revenue Service are under w addition, UnitedHealth has set up a dependent board committee and hired former SEC Enforcement William R. McLucas to review its tices. A spokesman says the boarc acted "promptly and appropriately."

Going back to 1994, McGuire ha ceived grants that coincided with lo the stock. If backdating occurred, i pears that UnitedHealth's board have known about the practice an proved it. According to McGuire's

loyment contract, he could choose rant dates and notify the compensa- committee. Legal experts say board eness would bolster his case that the ts were proper.

.ATION LURKING?

EVEN IF THE board approved the ıg of McGuire's options, that would bsolve him or UnitedHealth's direc- ntirely. While backdating itself isn't l, it must be disclosed to shareholdnd accounted for properly. Options ıave a strike price equal to the share on the day they're granted are taxctible for the issuing company; dated options aren't, according to a ıw enacted in 1993.

urces close to the investigations say ıtives or directors aware of backg could face charges related to the lack of disclosure and for overstating earnings. Ana-

> No one wants to see m dismissed"
>
> *—David Dreman eman Value Management*

ay UnitedHealth appears to have ac- ed for its options improperly: In May, it said it might restate earnings e years 2003-05 by up to $286 mil- fter review of earlier options grants. Guire also faces another potential ities law violation. If a company im- rly accounted for backdated op- and if that leads to restatements for ears since Sarbanes-Oxley went ffect, in 2002, investigators say the nd CFO could face charges of certi- false financial statements. While heory has yet to be tested, it's an egulators are studying.

antime, board members are digging another reason. Any concession of gdoing could increase their expo- o shareholder lawsuits. Already, di- s have been named personally in a rought by the Ohio Attorney Gener- e high-ranking ex-SEC official says ors-and-officers insurance might ay for people involved in securities ions. With their own wealth poten- at risk, "my guess is that their legal el is advising them to be very cau- " he says. "You won't see that board ything until it's forced to."

–With Joseph Weber in Chicago

BOARDROOM BIAS

The Ties That May Have Tied Directors' Hands

Well before questions arose about the timing of options grants for UnitedHealth CEO William W. McGuire, critics derided directors of the giant health insurer for lax oversight of its powerful chief. Some say UnitedHealth's board—which has included numerous former stars from the political and health-care worlds such as ex-Vice-President Walter Mondale and former Health & Human Services Secretary Donna Shalala—has been too deferential to McGuire. The tenures of United's board members (8 of the 10 outside directors have served for a decade or more) is also a red flag. Years of working together can lead directors to identify too closely with executives they oversee.

Another critical issue is whether outside ties influence what goes on inside the boardroom. While the individual connections may be benign, governance experts warn that such links can make it hard for directors to stand up to a CEO. "Few people choose to go through life confronting people who are conferring benefit on them," says Robert A.G. Monks, principal of Lens Governance Advisors. Here's a snapshot of key board members, their tenure, and their ties:

KEAN

James A. Johnson (1993). The head of the compensation committee, Johnson is vice-chairman of merchant bank Perseus, a former CEO of mortgage giant Fannie Mae, and a onetime political adviser to Mondale. Johnson chaired the John F. Kennedy Center for the Performing Arts from 1996 to 2004. McGuire's family foundation gave $15,000, and the United Health Foundation gave $5,000 to the center during that time; McGuire's wife also served on the Kennedy Center National Committee. Johnson and McGuire have also both been large donors to the Minneapolis Institute of Arts.

William G. Spears (1991). The senior principal of investment firm Spears Grisanti & Brown, he headed the comp committee from 1991 to 2003, overseeing the 1999 deal allowing McGuire to choose option grant dates.

Mary O. Mundinger (1997). Dean of the School of Nursing at Columbia University, she has been on the comp committee since joining the board.

William C. Ballard Jr. (1993). A member of the comp committee from 1993 to 1998 and the retired CFO of Humana Inc., Ballard was chairman and a shareholder of Healthcare Recoveries Inc. until August, 1995. Over the preceding four years, United paid $6.3 million to Healthcare Recoveries for help collecting claims overpayments.

Richard T. Burke (1977). UnitedHealth's CEO until 1988, Burke served on the comp committee in 1992-94. His wife worked for UnitedHealth from 1990 to 1996.

Thomas H. Kean (1993). A former Republican governor of New Jersey, Kean was on the comp committee between 1994 and 2002. He became chairman of the board of the Robert Wood Johnson Foundation, a health-care charity, in 2005. The United Health Foundation gave it $80,000 in 2004.

Gail R. Wilensky (1993). A senior fellow at Project HOPE, the global health foundation, and former policy aide to both Presidents Bush, Wilensky chairs the committee that oversees governance. She's an adviser to the Robert Wood Johnson Foundation.

Douglas W. Leatherdale (1983). The former CEO of insurer St. Paul Cos. is a life trustee and ex-chair of the University of Minnesota Foundation. The McGuire family foundation has pledged $10 million to the university's medical school, and in January, announced an additional $10 million donation to the university and two outside organizations. From 1992 to 1997, UnitedHealth also paid $4.4 million in insurance premiums to St Paul.

Walter F. Mondale (1991-93; 1997-2002). Mondale's law firm, Dorsey & Whitney, is UnitedHealth's outside counsel and has worked for the McGuire family foundation. The company also employed Mondale's son from 1992 to 1996.

The Fine Art Of Tech Mergers

How EMC transformed itself into an information management powerhouse

BY STEVE HAMM

WHEN EMC CORP. Chief Executive Joseph M. Tucci revealed in late 2002 that he planned to overhaul the down-on-its-luck data storage leader by acquiring software companies, most analysts were skeptical. After all, EMC was known for one thing only: building expensive cabinets packed with disk drives. And Tucci himself was a cipher. He had spent chunks of his career working for two of tech's mediocrities, Unisys Corp. and Wang Global Inc. So in 2003, Wall Streeters scratched their heads when Tucci bought Documentum, a document management company, and VMware, a pioneer in the arcane software that manages computers. They asked: What does this have to do with storage?

Not much, but that was the point. Now, three years, 17 deals, and $4.7 billion into an ambitious diversification drive, Tucci has quietly put together one of the most successful mergers and acquisitions records in the tech industry. All the while, EMC has hit earnings targets 13 quarters in a row. Software now makes up 37% of revenues, which grew to $9.6 billion last year, helping to land EMC the No. 20 spot on the BusinessWeek 50 list of top corporate performers. "Investors point to tech acquisitions and say it's unclear if they really work," says analyst A.M. "Toni" Sacconaghi Jr. of Sanford C. Bernstein & Co. "EMC has been fairly unique in being able to do them successfully."

To refocus EMC as a company that manages information rather than just stores it, Tucci aggressively acquired small niche leaders, many for under $100 million. The most he paid was $1.7 billion, for Documentum. "We go for the string-of-pearls approach as oppose the big, game-changing acquisitions says. Tucci is also after talent. It's a t ment to the Hopkinton (Mass.) cor ny's merger skills that 15 of the 17 executives of the EMC acquisitions remained with the company—typical run units within the software divisio

In 2003, Tucci dubbed Joseph F. ton, then head of EMC's services unit "integration czar" and gave him a w ing: "Don't mess it up. I'm going to s a lot of money, and I don't want yo crush their DNA." With a little help McKinsey & Co. consultants, W came up with a process that's part part science.

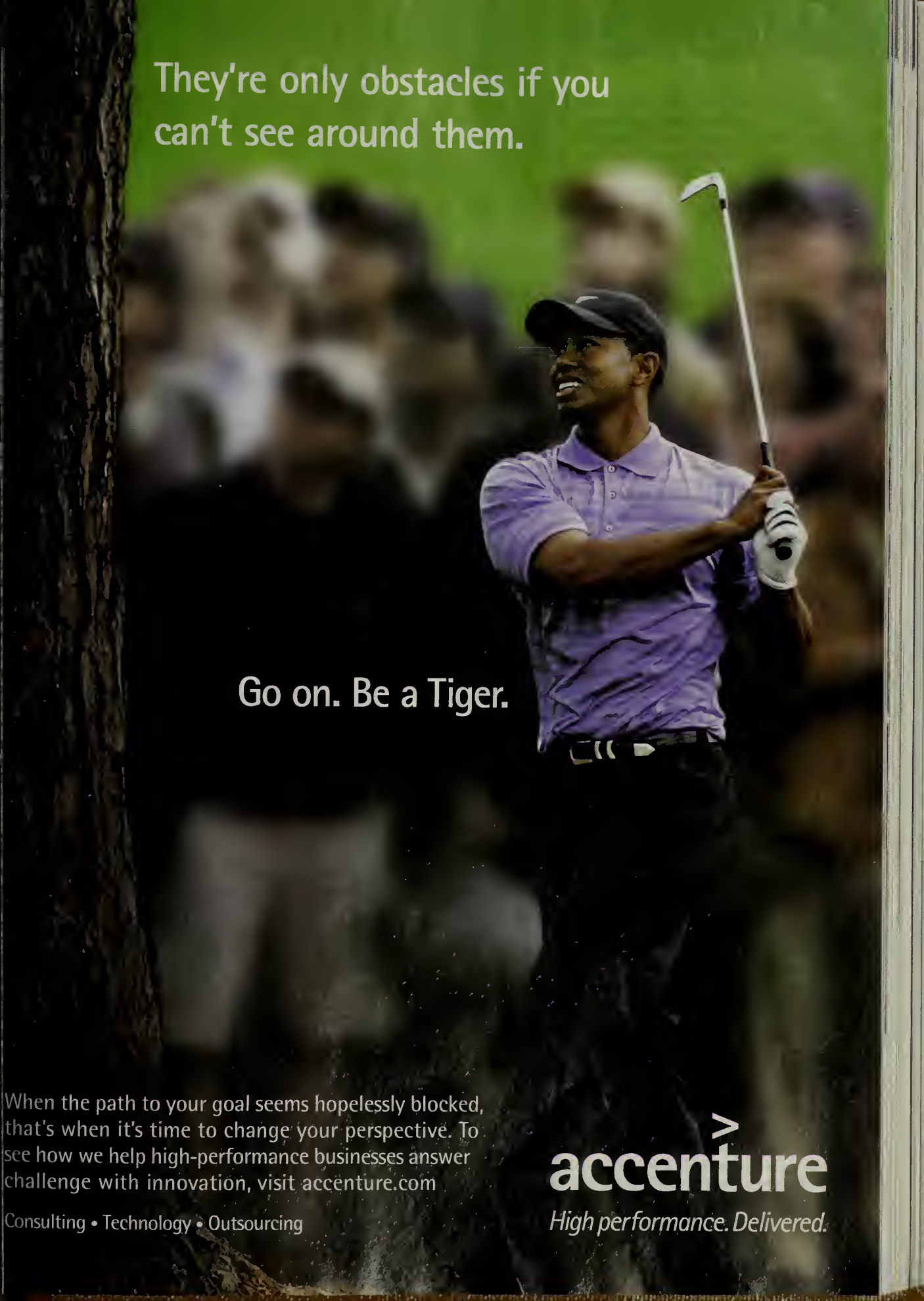
The science comes easier. Walto up an integration team, w once it had a couple of deal der its belt, created a play of processes for the preclos riod, the day of closing, an 100 days thereafter. It lay procedures for transition leadership, business processes, com systems, and sales. The performan each acquisition is tracked for six qua to make sure it makes steady prog Walton uses Six Sigma techniques to stantly improve the pro "This is a best practice," Robert F. Bruner, dean o Darden Graduate Schoo Business Administration a University of Virginia. learn from every deal, re what you learn, and diss nate. Then on successive you do better."

THE BUSINESSWEEK FIFTY 50 The Best Performers

MENTORING CEOs

THE ART, FOR EMC, is kee people happy and engage soon as a deal is done, Wal team and the leaders of th quired company customi plan for integrating into Usually after several mo the company is folded in other acquisitions to create business units, though VM continues to be run indep ently. To help the former thrive in a new organiza Walton assigns an exec mentor to each of them. He conducts cultural aware sessions with the employe the acquired companies.

DEALMAKER Tucci has boug 17 companies in three years


They're only obstacles if you can't see around them.
Go on. Be a Tiger.
When the path to your goal seems hopelessly blocked, that's when it's time to change your perspective. To see how we help high-performance businesses answer challenge with innovation, visit accenture.com
Consulting • Technology • Outsourcing
accenture
High performance. Delivered.

the Kofi Annan of EMC," he jokes.

It helps that the newcomers get opportunities they never would have had if they hadn't sold their companies. Take Larry A. Zulch, former CEO of Dantz Development Corp., which was a $20 million-a-year maker of data-backup software for smaller businesses when EMC bought it in late 2004. Within weeks, Zulch was asked to craft an EMC-wide strategy for the entire small- and medium-size business market. He proposed a full array of hardware and software for this segment. Tucci gave him a quick go-ahead. Within 10 months, he drew products from five other EMC business units, and last February he launched EMC's Insignia line—whose sales are off to a promising start.

Insignia is just one of many seeds Tucci has planted. Often, the software companies he buys are so young that they have scant revenues. (One had just $1 million in annual sales.) The idea is that once their products are combined with other EMC software in substantial packages that get marketing help from the company's 2,000-strong sales force, revenues will grow rapidly. Even Documentum, which had $300 million in annual revenues, has benefited from EMC's brawn. Its customer roster has doubled since its acquisition, and revenues have grown 60%.

Despite EMC's success, its shares have stagnated

If Tucci appears to have figured out how to get tech M&A right, he has yet to see that success heralded by investors. Like most other technology stocks, the company's shares have languished since 2003, rising but 5%. UBS analyst Ben Reitzes believes VMware alone could be worth more than $6 billion in a public offering—roughly 10 times what EMC paid for it. But when Reitzes raised the issue at an analyst conference on June 7, Tucci abruptly closed the discussion. "It's not a great idea to say: 'Here are my best assets. I'll get rid of them,'" Tucci told the crowd. Asked if she'd like to see the company spun off with an IPO, VMware President Diane Greene diplomatically ducked the question. "It's up to Joe," she said, shrugging. For now, Joe says no. But if EMC stock continues to stagnate, Tucci may be forced to make up a new playbook.

Eager Buyers For...Newspapers?

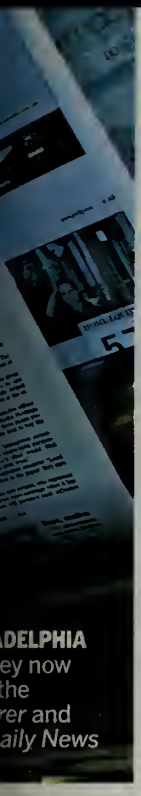
The rich, connected, and ambitious see a future in fast-growing Web ad sales

BY CHRISTOPHER PALMERI

WHEN PHILADELphia adman Brian P. Tierney announced at a press conference in late May that his group of local investors had bought the city's two big newspapers, *The Philadelphia Inquirer* and *Philadelphia Daily News*, from McClatchy Co., he did so with all the panache of Orson Welles in *Citizen Kane*. Tierney, 49, pretended to have a heart attack at the mention of the $562 million price tag. He kidded that he should be standing to the left of former Republican Governor Mark S. Schweiker, who was there to represent the chamber of commerce—an inside joke since Tierney is a conservative, too. He also sweepingl clared: "The next great era of Phil phia journalism begins today."

Could it be fun to own a newsp again? For the past six years the bus has been one sorry headline after an er: falling circulation, ads lost to th ternet, higher newsprint prices. Fe investors forced the sale of Knight der Inc. earlier this year. Now it's Tri Co.'s turn as the company's sec largest shareholder, Los Angeles' C dler family, pushes for a breakup.

The big story used to be the sale family-run newspapers to big nat chains. But now the door is open new generation of dreamers with m connections, and ambition galore. S al local billionaires are eyeing Trib *Los Angeles Times*, including Holly



dealmaker David Geffen and entrepreneur Eli Broad. Both men are big-time philanthropists and would likely relish the civic leadership role that owning a newspaper would bring. Onetime supermarket magnate Ronald W. Burkle, who has allied himself with the newspaper unions, made a run for some of the old Knight Ridder properties and is still in the market. His endgame: to show he can both save jobs and make money.

The interest in newspapers goes beyond civic pride. Although circulation for the industry's) dailies peaked in the early 1980s, 's 54 million subscribers still make print a powerful tool for advertisers. despite the gloom-and-doom head-, the business is very profitable. Big paper companies generated operat-rofit of 20% on sales of $52 billion year, says stock market researcher e Line Publishing Inc. Tribune's paper operations earned $760 mil-last year on sales of $4.1 billion. ite of the pressure from the Chan-, Tribune says the *Los Angeles Times* t for sale.

FFERENT TIME HORIZON'

SPAPERS ALSO have strong brand s that translate well online. William Singleton, CEO of the MediaNews p Inc. chain, with 49 dailies, says on-advertising at newspaper-affiliated sites is beginning to provide a er boost to bottom lines. Because the don't require printing and distribu-they're potentially much more able. Singleton online revenues up about 6% of company's $1.1 n in sales last but generated f profits. He re-agreed to buy former Knight r papers in ership with st Corp.

Without pressure from Wall Street, private owners can accept lower margins and returns. "We don't assume we're smarter than the people we're buying the property from," says Todd Schurz, president of Schurz Communications Inc. in South Bend, Ind., which recently agreed to buy South Dakota's *Aberdeen American News* from McClatchy. "We have a different time horizon." Schurz, a fifth-generation member of his family to run the company, says he doesn't plan to fire staff. "We don't think in terms of quarters—we think in terms of generations."

The horizon may be distant, but individual owners can move quickly when necessary. Canadian David Black, who recently agreed to buy *Akron Beacon Journal* from McClatchy, acquired the all-but-dead *Honolulu Star-Bulletin* at a fire-sale price of $10,000 in 2001. He snapped up a successful weekly paper for its presses, brought in local investors to win community support, and created a Sunday edition. Black now claims to have a significant chunk of print advertising on Oahu.

Still, the track record for outsiders isn't great, says industry consultant John Morton, citing the cases of real estate developer Peter S. Kalikow's failed tenure at the *New York Post* and industrialist Joseph E. Cole at the now defunct *Cleveland Press*. Mortimer B. Zuckerman, the real estate mogul who rescued the *New York Daily News* in '92, says dealing with shrinking revenues and higher printing costs is a constant struggle. "We've been bloodied," he says.

New owners face many of the same challenges as their predecessors, plus an added hurdle: They're deeper in debt. Tierney and his team, for example, are borrowing heavily from Wachovia Corp. and Royal Bank of Scotland. "It's possible banks will put on the same kind of pressure as Wall Street if revenues don't go up," says Gene Forman, an ex-*Inquirer* editor who now teaches at Penn State.

In Philadelphia, Tierney & Co. will have to deal with 12 separate unions, whose contracts all come up on Aug. 30. So the honeymoon could be short. "The idea of local ownership is exciting," says Joseph Lyons, president of the Philadelphia Council of Newspaper Unions. But, he cautions: "We'll probably get into some serious bargaining" with a new boss who has never worked with unions. One likely issue: the two papers' separate sets of delivery-truck drivers. Combining them would probably save money but cost jobs.

A Philly native, Tierney founded an ad and PR agency, now part of Interpublic Group of Cos., that he built up to $260 million in revenues before leaving in 2003. While there, critics say, Tierney strong-armed editors in defense of his clients. Tierney says he made his new investors sign pledges saying they won't meddle in news coverage. "The publisher makes the decision. I won't attempt to interfere," he says. "I don't know what more I can do." ■

CITIZEN KANE In the film, Orson Welles plays an all-powerful newspaper owner

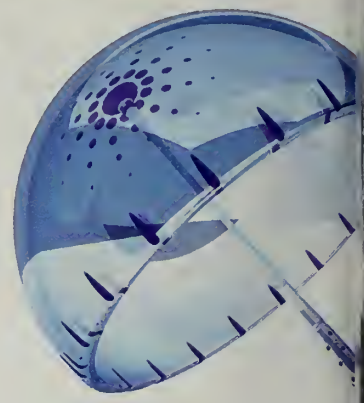
Read All About Online!

Ad sales on newspaper sites are still small vs. print, but they're climbing at a brisk clip

WEB AD SALES GROWTH*	PRINT AD SALES GROWTH*
35%	0.3%
$613 MILLION	$10.5 BILLION

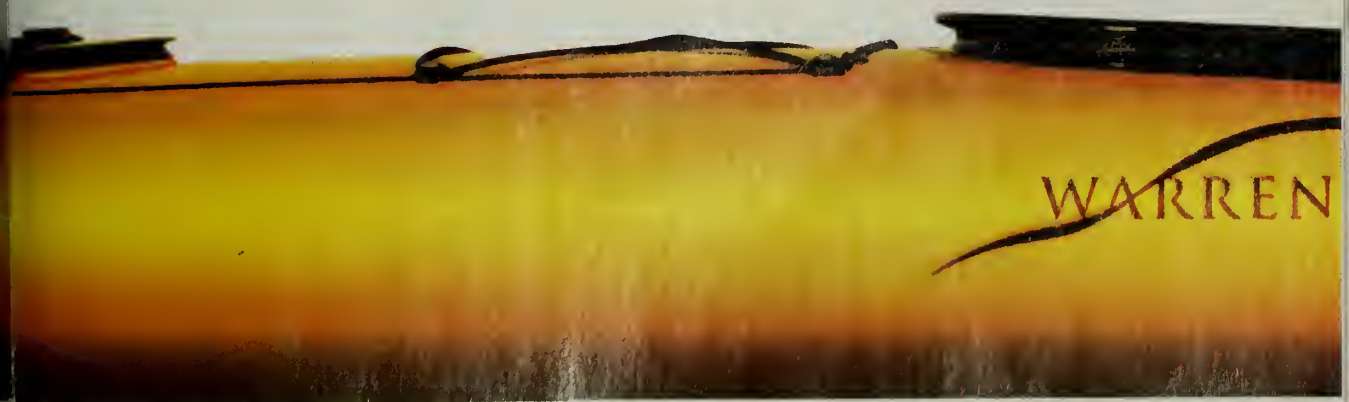
*First quarter, 2006

Data: Newspaper Association of America



Winners The Best I

duct Design of 2006



BRONZE

X-Base Tribord

Designer: DECATHLON, France

Great colors, variable nosepiece, better fitting face shape, and a one-piece holding strap/sealing gasket makes this underwater goggle a winner.

GOLD

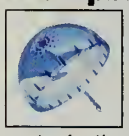
Kodak EasyShare V570 Dual Lens Digital Camera

Designer: Eastman Kodak & blueMap design

The first dual-lens digital camera, and the thinnest. It's an ergonomic treat that hides the technology and favors the people who use it. A jury favorite.

BRONZE

"Bumpbrella" Concept Umbrella



Designer: RKS Desi

An inflatable umbrella t uses a bicycle pump in center for the arm. You can see throug it looks great. A totally new umbrella d looking for a company to execute.

FOR COMPANIES WORLDWIDE, DESIGN has become strategic, the very core of their efforts to differentiate what they make and do. But is design itself becoming a commodity? Consider this. What was once thought of as great design is now seen merely as good, what was once exceptional is now standard. Managers everywhere are turning to rapid ethnography, usability, special materials, and aesthetics—the tools of design—to innovate. The differentiation of products and services increasingly requires a much higher level of execution. In design, the bar is raised.

Nowhere is this so apparent as in the 2006 Industrial Design Excellence Awards (IDEAs). Winning the gold this year took more design excellence than in previous years. Jurors said that relevance and looks were just the basics for consideration. Products needed an element of delight to win the gold. Sponsored by *BusinessWeek* and judged independently by the Industrial Designers Society of America (IDSA), the contest is one of the most important of its kind.

What were the key surprises this year? The strong showing by Asia is clearly one of the most striking trends. Panasonic won six awards, twice as many as the next winner and far more than any U.S. or European corporation. China's Lenovo Group Ltd. computer maker took two golds, the most of any company. Samsung Group won a gold and two silvers and still leads all global corporations, including Apple Computer Inc., for the most IDEA wins over the past five years.

In 2006, according to the IDSA, "the percentage of gold winners with design teams from Asia" came to 25.9%. This is a dramatic increase from 7.9% of the golds last year and 8.1% in 2004. The strong showing by Asia reflects a tremendous investment in design. Of the 1,533 entry kits sold for the contest, Asian companies and institutions bought 318. This is up from a dozen, most-

GOLD

2Seconds Quechua

Designer: DECATHLON, France

Spring hoops allow you to throw this tent into the air, and it opens before hitting the ground. The two-person tent takes 2 seconds to open and 15 seconds to close.

CANOE THIS PAGE AND PREVIOUS: LIPSON PHOTOGRAPHY/CHARLIE LIPSON

Protective Helmet

Designers: fuseproject; Pulsium Engineering, France; Pryde Group, Hong Kong

djustable plates on the interior to fit iers and snowboarders. That's a big re from the usual solid helmets and s. The design also drives supply- ficiency. And it looks cool.

SILVER

Hundred-Dollar Laptop Computer

Designer: Design Continuum

An MIT Media Labs project to deliver inexpensive laptops to children in Africa, Brazil, China, India, and Thailand. A hand crank provides electricity. Linux software. The price is now up to $140.

GOLD

ResQTec hydraulic rescue tools

Designer: VanBerloStudio's Design Team, The Netherlands

A classic example of the visual and functional. Fast, efficient, can be used by men and women. The look and feel convey a sense of confidence to the rescuer and the victim being rescued.

ly bought by the Japanese, a decade ago. Today, Chinese, Taiwanese, Korean, and Hong Kong companies and their governments are committing huge resources to design in order to build global brands. They are competing less and less on price and more on differentiation, relevance, and value to the consumer.

Take Lenovo. It won a gold for its Opti Desktop PC, designed for tech-centric gamers in China. Perhaps more important, it also won a gold for the design research it did for the Opti with ZIBA Design Inc., based in Portland, Ore. That research, dubbed "Search for the Soul" of the Chinese customer, helped Lenovo move beyond competing on price, where it was being hit hard by Dell, Hewlett-Packard, and IBM in China. Lenovo and ZIBA delved deeply into Chinese consumer culture to "find out which design elements have meaning and value for specific groups of Chinese consumers," according to the IDEA entry form. ZIBA and Lenovo spent months immersed in Chinese music, history, and objects of desire, such as cell phones, observing families as they lived, worked, and played. In the end, they identified "five technology tribes" in China: Social Butterflies, Relationship Builders, Upward Maximizers, Deep Immersers, and Conspicuous Collectors, each with different needs. The Opti was designed with shapes and colors for Chinese Deep Immersers who seek escape through immersing themselves in games online.

Juror Don Norman (author of *Emotional Design* and *The Design of Everyday Things*) said: "At first the judges said 'yuck' to the design but then changed their minds when the research showed the Chinese didn't want our sleek U.S. design but their own from their own culture."

ZIBA had the most wins of any single design consultancy—four medals, three of them golds. It won a gold re-

GOLD

Little Wing

Designer: Warren Light Craft

Starting from a deep understanding of the needs of kayakers, it is sculpted to provide speed traversing lakes or seas and stability going slow or at rest.

search-strategy award for one of the jury's favorite products, the Sirius S50 satellite radio. This product reinvented the prevailing idea of satellite radio by simplifying the experience while allowing people to save and manage the music they get from satellite. "They put it all together so well," said juror Alistair Hamilton, vice-president for corporate design and human interfaces at Symbol Technologies. "Now you can take your satellite music with you and manage it."

There were other products that filled the IDEA jury with delight. Eastman Kodak's EasyShare digital camera was a huge smash and won a gold. Chris Conley, jury chairman, called it "stellar" in the way it was designed to bury the technology and make it easy for people to operate. Crown Equipment Corp. won again this year with a silver for its TSP6000 Turret Stockpicker. The 2Seconds Quechua tent by the French company DECATHLON, which opens up like a butterfly when you throw it into the air, won big applause and a gold. The British Intelligent Energy ENV Bike, designed to show off its hydrogen fuel-cell propulsion system, won a gold. "It was designed to sell the new technology," said juror Hamilton. "People will understand that it is viable and use it."

For the first time, the IDSA presented awards in "Ecodesign." Two office chairs, a pair of water shoes from Timberland Co. and Keen Design Group, and a digital carpet-sampling system that did away with the fabric won. Jurors weren't happy with the low number of entries. "The design community is not knowledgeable in this," said jury Chair Conley. "Architecture is better."

U.S. design schools also did well in this year's competition. Both the Art Center College of Design in Pasadena, Calif., and Pratt Institute in New York won two awards apiece. U.S. corporations didn't fare as well. Timberland, a maker of footwear and clothing, won the most of any U.S. company with three awards, and Eastman Kodak won a gold and ver. But the rest of the top tier was filled by Canada's BRP bardier Inc./Learjet Inc.), with two; France's DECATHLON a gold and bronze; the Netherlands' Philips Design, gold and a bronze; and three Asian companies—K Samsung, with three awards, and Japan's Panasonic an na's Lenovo, each with two. Food for thought.

Another big surprise was the absence of familiar desi innovation consultancies in the winners box. IDEO Inc. win anything this year. Nor did @radical.media or Sma sign Inc. Fresh names such as Atlanta-based Formation Group, New York-based blueMap Design, and Munich designafairs did well.

There were fewer winners in 2006, just 108, down fro last year. There were only 27 golds, vs. 2005's 38. Clea a tougher playing field. There were 995 entries from th and 499 from 28 other countries. The design game creasingly global.

For additional award winners, read on. ■

–By Bruce Nussbaum in Ne

Winners for 2006...

Who took the medals at this year's Industrial Design Excellence Awards

DESIGN FIRMS	AWARDS			
	GOLD	SILVER	BRONZE	TOTAL
ZIBA	3		1	4
Formation Design Group	1	2		3
Antenna Design NY			2	2
blueMap design	1	1		2
Davison Design & Dev.		1	1	2
Design Continuum (Italy)	1	1		2
designafairs	1	1		2
Ergonomic Systems Design	1	1		2
fuseproject	1	1		2
Karim Rashid			2	2
Keen Design Studio			2	2
Lunar Design		1	1	2
Newdealdesign			2	2
Stuart Karten Design		1	1	2

CORPORATIONS/SCHOOLS	AWARDS		
	GOLD	SILVER	BRONZE
Panasonic	1	2	3
Samsung	1	2	
The Timberland Company		1	2
Art Center College of Design	1	1	
BRP (Bombardier/Learjet)		2	
DECATHLON	1		1
Eastman Kodak	1	1	
Lenovo IDC	2		
Philips Design	1		1
Pratt Institute	1		1

...And Over Five Years

DESIGN FIRMS	AWARDS		
	2002-2005	2006	TOTAL
IDEO	39	0	39
Design Continuum (Italy)	16	2	18
fuseproject	14	2	16
Smart Design	16	0	16
ZIBA	10	4	14
Lunar Design	10	2	12
Altitude	8	1	9
RKS Design	7	1	8
Antenna Design N.Y.	5	2	7
Newdealdesign	5	2	7
Karim Rashid	4	2	6
Pentagram	5	1	6
@radical.media	5	0	5
designafairs	3	2	5
Formation Design Group	2	3	5
Herbst LaZar Bell	5	0	5

CORPORATIONS/SCHOOLS	AWARDS	
	2002-2005	2006
Samsung	16	3
Apple	14	1
Hewlett-Packard	11	1
IBM	10	0
Philips Design	8	2
Art Center College of Design	7	2
BMW	9	0
Logitech	9	0
Nike	9	0
Panasonic	3	6
Black & Decker	6	0
DaimlerChrysler	5	1
Kohler	5	1
Motorola	5	1

Beyond the Page

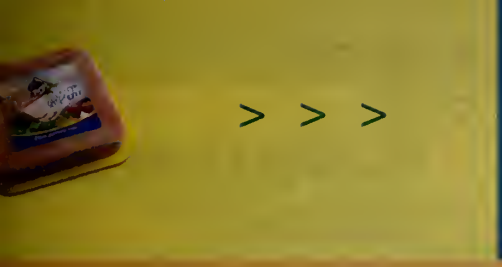
Slide Shows: A presentation of all winners, including Nokia's L'Amour phone (right) and an evolutionary tour of cameras. Plus: The design stories of Kodak's dual lens EasyShare, Lenovo's Opti computer, DECATHLON's tent, Crown's Stockpicker, and the Hundred-Dollar Laptop

Q&A: Meet Panasonic's design chief

Grab Your TV Clicker: See many of these products in action on BusinessWeek Weekend. Check your local listings or go to businessweekweekend.com

BusinessWeek online

businessweek.com/extras



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housands of narrow streets in cities and villages all over
al America, you'll find tiendas ... tiny stores selling groceries
ssentials. Food companies face a unique challenge delivering
erated foods to these out-of-the-way places. So Cargill's supply
specialists fit a solution to the need. Sales representatives
on maneuverable motorcycles equipped with iceboxes and
held computers ... delivering the products tiendas need, when
need them. Proving that a delivery system doesn't have to be
o be efficient. This is how Cargill works with customers.

laborate > create > succeed

cargillcreates.com
argill, Incorporated

Cargill
Nourishing Ideas. Nourishing People.™

SILVER

Zody

Designer: Haworth; ITO-Design

All of the aluminum parts can be recycled, and wind power energy was purchased to run the plant that manufactured the chairs. A take-back program recycles all materials.

GOLD

SIM from Tricycle

Designer: Tricycle

A system for digitally modeling carpets and textiles so manufacturers can make prototypes of new designs without making samples for architects and interior designers. This cuts costs and helps the environment.

SILVER

Timberland PreciseFit system

Designer: Timberland Invention Factory

A series of inserts allows men to customize their shoes. It eliminates the need for half sizes and helps the 35% of the male population with differences between their left and right feet.

BRONZE

Mion Footwear

Designer: Keen Design Studio, Timberland Invention Factory

The ergonomic water shoe molds to your foot. A single piece of rock-climbing grade cord wraps around the foot for adjustability and support. Simple, recyclable materials are used as well. A sculptured look.

Going Green Globally

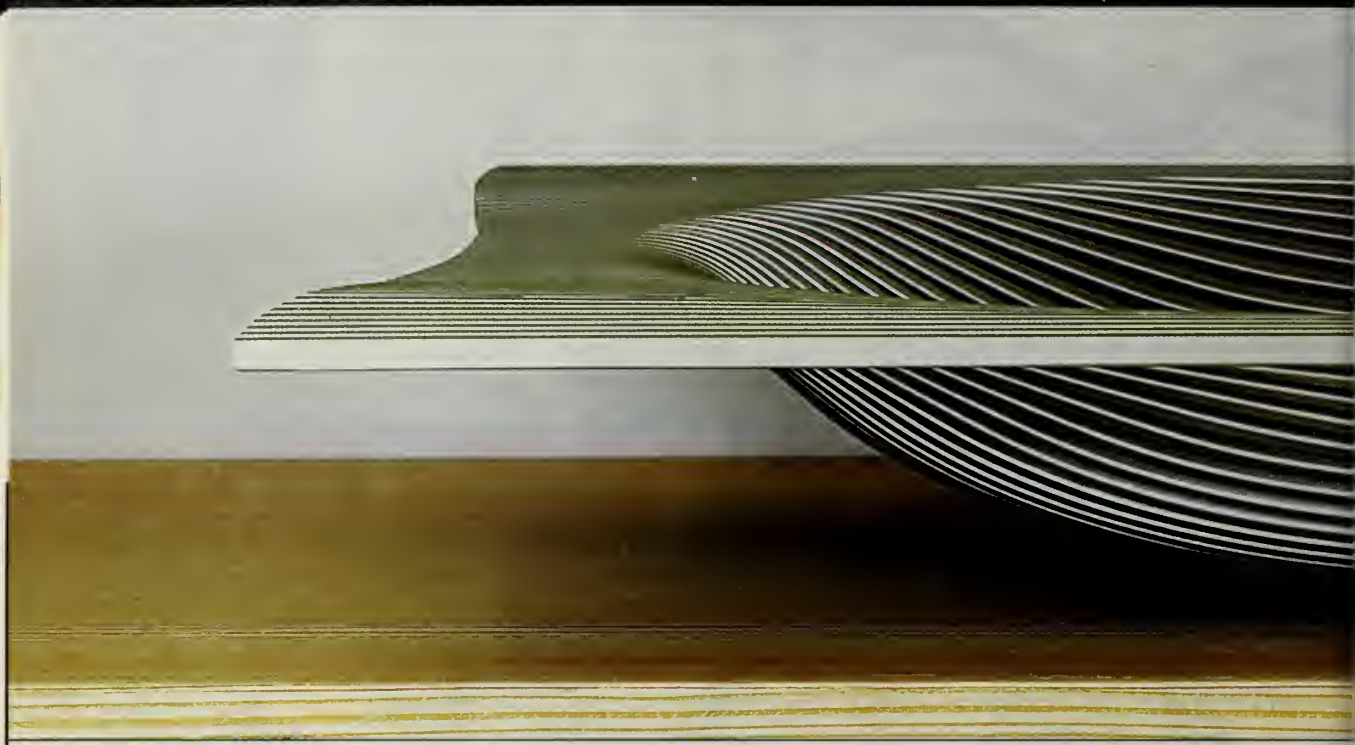
GREEN TECHNOLOGIES are spreading fast from one industry to another. Architecture has definitely taken the lead, but we are seeing important green breakthroughs in transportation, consumer products, and office furniture. Green materials are in hot demand, and more corporations are offering "take-back" programs to recycle what they sell. Is the global economy at the tipping point when it comes to going green?

GOLD

Intelligent Energy ENV Bike

Designer: Seymourpowell, Britain; Intelligent Energy, Britain

It's the world's first hydrogen fuel-cell motorcycle. An "alien" design turns heads as it moves silently through streets.



SILVER

A/Design Bowl

Designer: designafairs, Germany; Fielitz, Germany

This beautiful fruit bowl was made out of aluminum sheet metal that was folded and stamped to the outer limits of the metal's physical properties.

GOLD

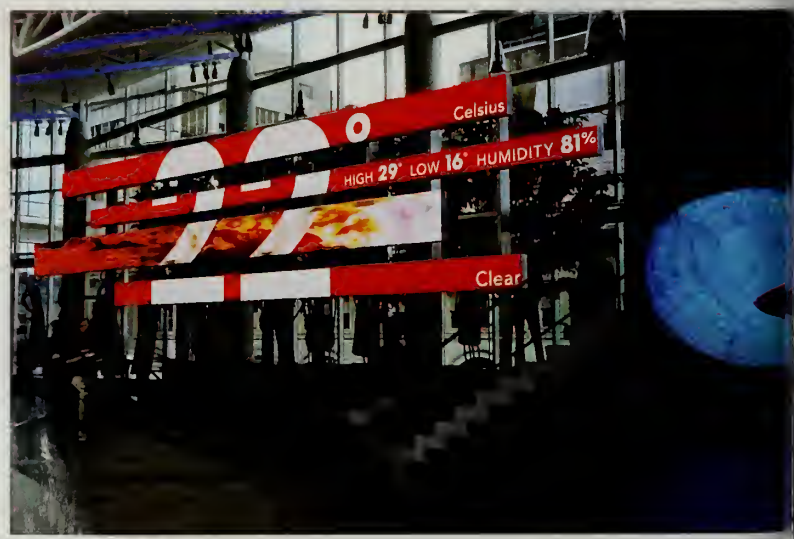
Bloomberg Corporate Headquarters

Designer: Pentagram Design

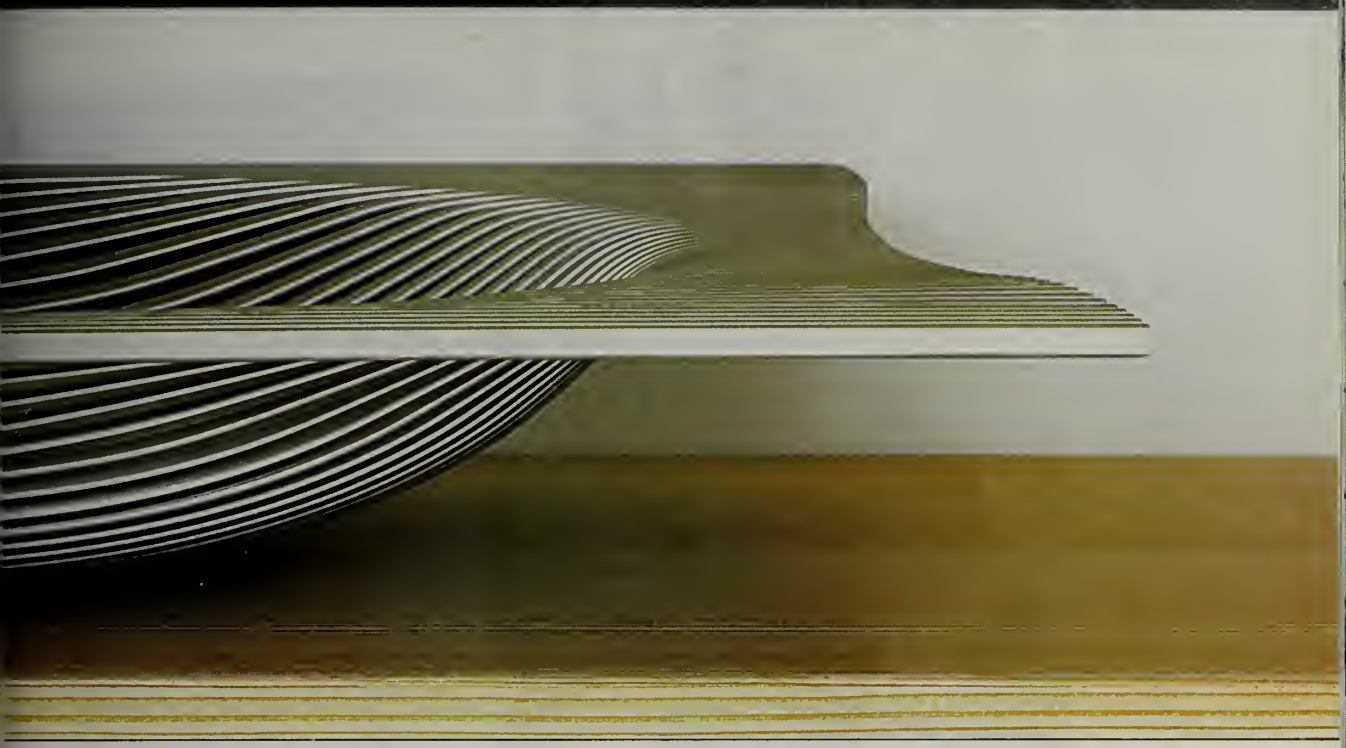
Signs of oversize numbers encased in floor-to-ceiling glass, huge electronic displays, and directories etched in glass.

Material, Whirled

WHETHER IT'S low-energy LED lighting, recycled steel framing for prefab housing, or plain old aluminum used in new ways, materials are playing a bigger and bigger role in design and innovation. Special materials, or old ones used in new ways, can save money, cut energy costs, and ease the burden on the environment. Every big design consultancy in the U.S., Europe, and Asia is learning this lesson.



(BOTTOM LEFT) PHOTOGRAPH BY PETER MAUSS/ESTO



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that features an
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vement.

SILVER

Marmol Radziner Prefab

Designer: Marmol Radziner + Associates; Green Dragon Office

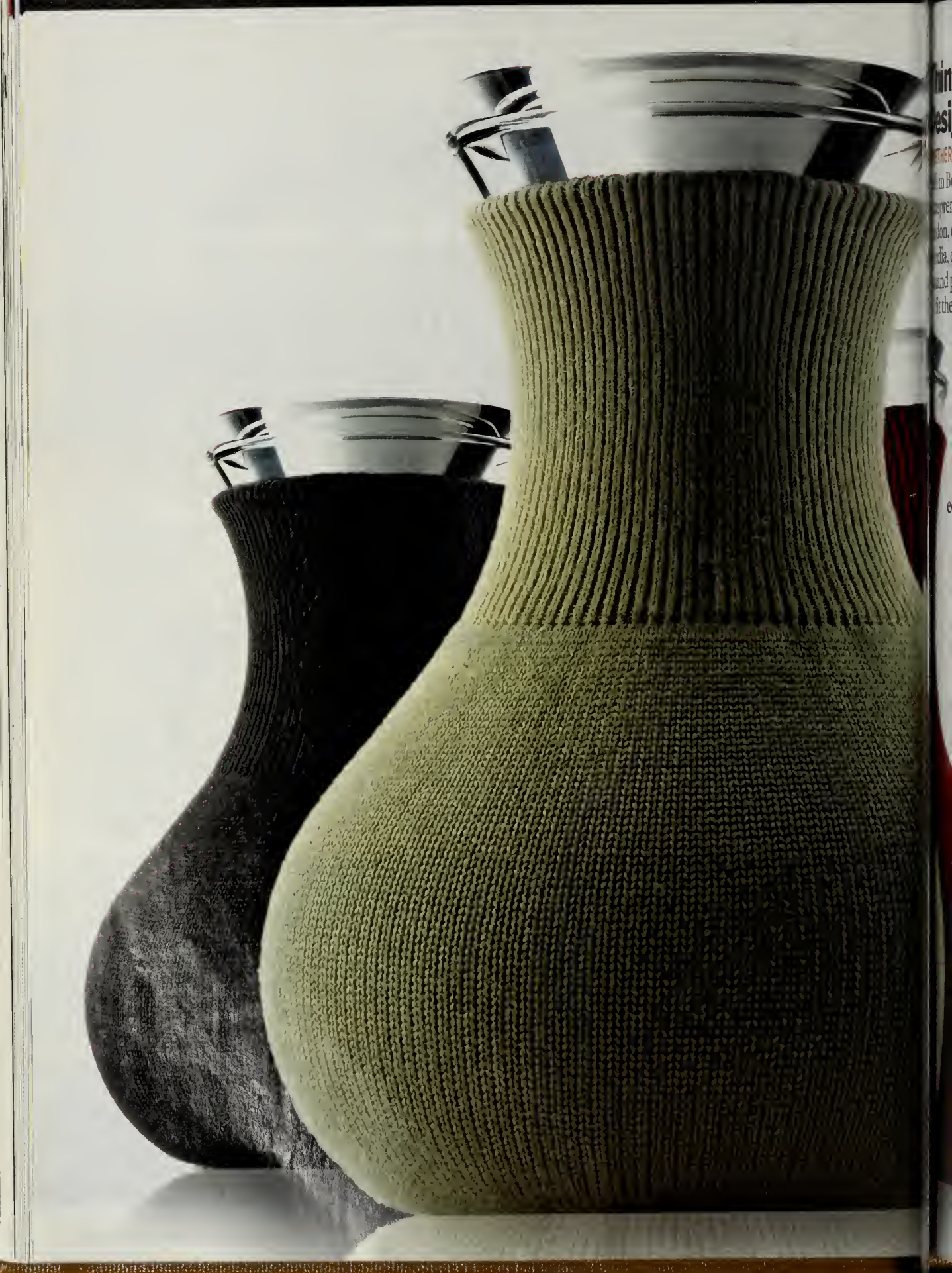
Design your steel-frame home online and get it built fast. Prefab houses with decks, open plans, lots of glass, and a modern look. Framed with recycled steel, not wood.

GOLD

CityWing

Designer: Philips Design, The Netherlands

Lighting units for shopping areas, squares, pathways, and public spaces that make use of light-emitting diodes. LEDs sharply reduce the use of energy, while aluminum poles make for easy recycling.



hink Globally, esign Locally

THER IT IS the rich kid hitting the l in Beverly Hills, an epreneur out on the town in don, or a family making $2 a day ndia, consumers increasingly and products and services that it their lives. This cuts across market lines, from luxury to technology, from transportation to entertainment. Designing for local cultures is becoming critical in the global economy.

GOLD

Eva Solo Tea Maker
Designer: Tools Design, Denmark

A metal lip makes it drip-free. A new filter system allows for two ways of brewing: You can put tea leaves directly into the glass jug or put them into the cylindrical filter, which allows you to drink the tea without removing the leaves. A fabric cover keeps tea hot while protecting your hand and the tabletop.

GOLD

Wall-Mounted Digital Projector (AN110)
Designer: LG Electronics, South Korea

Designed as a modern object of art, this projector can hang on the wall behind the couch and not take up space in the room. It breaks the mold.

BRONZE

WaterTile
Designer: Kohler Industrial Design

Tiles, not pipes, make this "body spray" shower very different. Multiple spray heads are seen as a luxury, but this design lowers the cost and makes a custom shower more widely available.

SILVER

AMD Personal Internet Communicator (PIC)
Designer: M3Design

A low-cost, easy-to-use basic computing device to provide access to the Internet in poor villages and towns around the world. Simple design allows easy use and manufacture. Rugged.

BRONZE

The BikeBoard Product Line
Designers: Davison Design & Development; BikeBoard Co.

This hybrid blends two old favorites—the bike and the skateboard. The design makes the skateboard easier to maneuver and more stable.

GOLD

Lenovo Opti Desktop PC
Designers: ZIBA Design; Lenovo Group, China

Research into the values, behaviors, and goals of different kinds of Chinese computer users led to a PC for "deep immersers." Exposed fasteners (bad in Western design) worked for China's PC gamers. It conveyed raw power.

BRONZE

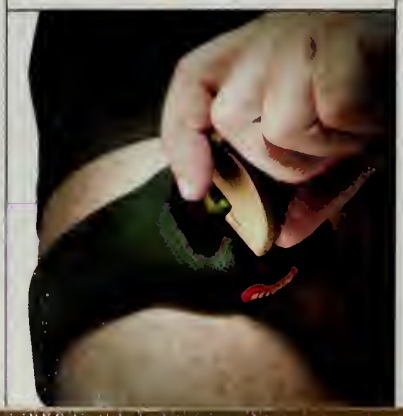
Camcopter S-100

Designer: heufler design, Austria

Designed for civilian and military use, this small, unmanned helicopter can do search and rescue missions, map and survey work, mine detection, and monitoring of vital installations and environmental disasters.

Design for a Dangerous Planet

HURRICANES, PLAGUES, CRIME, TERRORIST ATTACKS—we now live in a world of increased peril. Designers are addressing the issue by rethinking and improving standard medical applications, such as the age-old tourniquet, while coming up with novel products that deal with new threats to our safety. These include quick and easy-to-use ways to detect biochemical threats, cheap emergency shelter for displaced families, and high-tech solutions to terrorist threats. Great design really can be a life-or-death issue.



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FirstDefender Handheld Raman Spectrometer

Designer: Altitude Inc.

This user-friendly and rugged handheld detector for firefighters, police officers, soldiers can quickly determine the pres of explosives, radioactive isotopes, nar anthrax, and chemicals.

BRONZE

Cocoon Disaster Relief Shelters

Designer: NewDealDesign

These low-cost, easy-to-assemble disa shelters can be air-dropped after a tsu or other disaster. Three designs—Case Cuddle (2, a dual poncho/sleep sac), a Capsule (3)—cover all disaster needs.

GOLD

Cybertech MAT Mechani Advantage Tourniquet

Designer: Cybertech Medical; Ev Design Group

Simple design makes applying this one-handed tourniquet intuitive, allowing pe save their own lives. And the tension-loc buckle for cinching it works in extreme w

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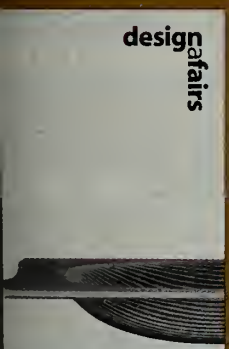

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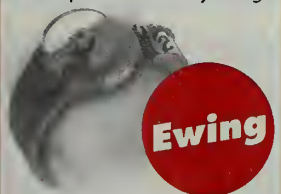

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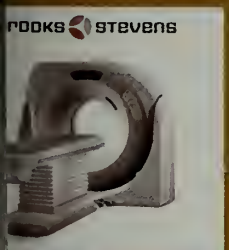

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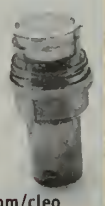

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This site lists a brief description of the companies in the directory, along with contact numbers and company hotlinks. It also features the IDEA Showcase of the 2006 IDEA winners, current industrial design news and resources, hotlinks to related sites and a calendar of design events.

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BusinessWeek

Grading The Gateses

Whether by e-mail or snail mail, reader reaction to our cover story was passionate

BY WILLIAM C. SYMONDS

Through years of writing about education, one thing I have learned is that our readers care deeply about America's public schools. So we expected a lot of reader reaction from the Cover Story my colleague Jay Greene and I wrote, "Bill Gates Gets Schooled" (June 26), and we weren't disappointed: Well over 100 letters and online postings, many passionate, have arrived so far.

Some readers scolded us for our skeptical assessment of the Bill & Melinda Gates Foundation's efforts to fix failing high schools. "The foundation deserves an A for making the effort," responded James Warren, an editor for the *Chicago Tribune*, in a review of our article in that paper on June 19. Warren was especially disappointed that we began with an account of the failure of the foundation's efforts to remake Denver's troubled Manual High School. "The story could have instead opened with bona fide Gates successes," he wrote.

Other readers questioned the foundation's accomplishments. "There are no quick fixes. The Gateses' approach will yield some successes, but overall they will have the same impact as a mosquito bite on an elephant's ear," wrote an online reader. Similarly, an angry teacher posted: "It rankles me that so many who have never taught believe know how to 'fix' the schools.... Let's leave teaching to the teacher let Mr. Gates and friends 'fix' Windows."

We heard from a number of teachers directly involved with Gat funded schools, and though opinions were divided, all agreed the is difficult. Gary Nelson of Bountiful, Utah, left his publishing job t launch a charter high school patterned after San Diego's High Tec which we profiled. "The experiment has proven how difficult creat new schools can be," Nelson wrote, adding that he left several mo ago feeling his contributions "were no better, and probably much than the teachers and administrators at traditional high schools."

Many readers suggested there were other reforms that had as if not more, promise as the Gateses' small-schools approach. Sor focus on improving teacher quality. "Family, family, family—correc parents first, and the kids will learn in almost any environment," w one online writer, summing up an oft-expressed view. Others advo everything from using modern brain science to developing profes schools like those in Japan. Here is a sampling of what our reader

> "While the couple merit praise for calling national attention to the crisis and funding some promising schools, they deserve no better than a C when it comes to improving academic performance."
> *–from "Bill Gates Gets Schooled"*

At least the Gateses are trying. I cannot be critical or say that it is money wasted. Is it the silver bullet? Not likely. Will it generate data that social scientists, educators, and politicians can use to build forward momentum? Absolutely. Progress, not perfection. What have you done to advance society and make the world a better place today?

> *"Rich," posted June 16*

Holding schools accountable to Gates for funding is absolutely meaningless if Gates doesn't hold senior managers in [his] K-12 unit accountable for results. Learning curve or not, [his] managers spent $1 billion and got very little back. If Gates found this true at Microsoft, he would change management.... Second, Gates pretty ignored the experience of big-name executives like Lou Gerstner, Phil Con and David Kearns at New American S Development Corp. That investment yielded the best evaluations of progra effectiveness to date. If Gates is serio about sustainable quality at scale, he to clean house, change staff incentive get scalable models.

> *Marc Dean Millot, editor,* School Impro Industry Weekly, *Alexan*

I am impressed that the Gateses are publishing results, even though they negative. Of course, that seems logi them. Every other profession—excep education—publishes results from experiments whether they worked o

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So while medicine no longer pours boiling oil on wounds, education continues to recreate past mistakes. Bottom line: The Gateses should keep telling the truth about their return on investment in education.

> *Kathleen Madigan, Washington, D.C.*

It should be no great surprise that [their] efforts are producing lackluster results. The good people behind these initiatives do not have a grasp of cause and effect, at least in urban areas, where the need does seem greatest. And they're way too confident in their ability to tell a "successful" school from a "failing" one.

> *Bill Stoneman, Albany, N.Y.*

"[The Gateses] view their crash course as R&D for educators nationally who are trying to sort out what works and what doesn't."

–from "Bill Gates Gets Schooled"

The answer to better student performance is to base teachers' pay directly on student testing. Do this using a five-year running average (to wash out student quality anomalies) of a teacher's twice-yearly administered test results.

> *Elmer F. Clune, Tonawanda, N.Y.*

Even with new buildings, smaller schools, visionary principals, committed teachers, and the best tests money can buy, it's difficult to overcome a home life that does not value education. As long as parents send kids to school without pencils, do not respond to teachers' requests for conferences to discuss a failing student, don't set limits on behavior, and don't read books or newspapers, there will be kids left behind.

> *Howard Flantzer, Kendall Park, N.J.*

International test data show that overseas kids do better in math and science. Are they smarter? No, they go to school a longer day and year—230 days a year in China, 220 in Korea, and 210 or more in Japan, vs. an average of 180 in the U.S. Add up the difference over a 13-year school career, and Asian students receive two to more than four years more academic instruction. Controlling for this variable alone virtually wipes out the difference in test scores.

> *James P. Lenfestey, Minneapolis*

One fundamental assumption by Gates is wrong. He is trying to make all students, regardless of their background and personal abilities, go to college. This is not possible even with all his money. The point of education should be to give all children some professional and technical training so that they can make a decent living.

The Japanese have had professional schools at the secondary level since the early part of the 20th century, including engineering, business and accounting, agriculture and forestry. So children from the poorest families could get some degree of training. BusinessWeek.com [noted] the National Academy Foundation effort to run 500 career academies. This is the closest to what the Japanese are doing and will be the most effective.

> *Dr. Pinghui V. Liu, Boca Raton, Fla.*

Allow the dollars to follow the students, and I guarantee you that all schools will either get better or die.

> *Jeffrey T. Pett, Holland, Mich.*

There is far too little discussion of how to use brain science. Using new tools to develop cognitive skills—our basic ability to learn and process information—could move students much farther, much faster. The mind is not a vessel to be filled bu fire to be kindled.

> *Betsy Hill, Wilme*

"'The transition from th old, big schools to the small schools has been more complicated than we expected,' says a Gat grantee in New York Ci

–from "Bill Ga Gets Schooled"

I worked in the Bronx as a high school teacher. Our large school was divided small schools. The best students wer sloughed off into the small schools, allowing administrators to crow abou progress. Other students, most socia promoted to high school, were left wi role models. Once the "average" stud admitted into small schools, "progres will evaporate.

> *Ric Klass, Westchester Cou*

I work in one of the Gateses' small schc my opinion, small schools can work. B there must be: 1) commitment from th district, because modifications to procedures are sometimes needed; 2) ability to hire motivated staff at all leve (having uncommitted, unmotivated st like having huge boulders tied around neck); 3) a focus on instruction and evaluation; and 4) alternative placeme students who repeatedly break school

> *"Committ posted*

BusinessWeek online Read "Bill Gates Gets Schooled" from BW's June 26 issue, and r online extras at **http://www.businessweek.com/magazine/toc/06_26/B3990magazin**

)ne person is diagnosed
vith Parkinson's disease
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)in the battle.

rkinson's disease is a chronic, degenerative neurological disorder that
fects more than 1 million people in the United States alone. 60,000
w cases are diagnosed each year. **That's one every nine minutes.**

rrently, there is no cure for Parkinson's disease.

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more information on Parkinson's disease or to support our quest
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e its inception, the Walk has raised more than $5 million for Parkinson's research by uniting the community under
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A 'Mayo Clinic' For Your Game

Once only for pros and insiders, Titleist and Callaway have opened their high-te training centers to golfers with everything but a great swing. **BY MARK HYMAN**

T DOESN'T LOOK LIKE a six-handicapper's idea of paradise. There are no sweeping ocean vistas, and the dominant architecture is best described as "early concrete block." Yet for those with dreams of winning a U.S. Open, or just correcting an infuriating slice, few sights are as pretty as the little-known Titleist Performance Institute in Oceanside, Calif., about 40 miles north of San Diego. For years, TPI was the playground of design engineers testing the next generation of Ti- clubs and golf balls. Pro golfers with Titleist deals, including e Els, also have been known to pop in to TPI for emergency club gs or to tinker with their swings. ¶ Now the door is also open to us golfers who have everything but the perfect backswing. For a $5,000, Titleist offers lavish two-day packages, complete with g gurus, high-tech analysis, and loads of personalized goodies.

at's a caddie's tip compared with the 00 rival Callaway Golf will be charg- r its VIP Experience about seven way in Carlsbad, starting this sum- he companies' two-day getaways ex- mateurs to every advantage that the s best players draw on, except natu- lity. At Callaway, guests will even me a personalized bag and a full set om-fit clubs. (Previously, Callaway fered VIP club-fittings for a handful orate partners and celebrities par- he company's products.)

n at these heady prices, the pro- have found an audience. TPI is l through next summer. Actors el Douglas and wife, Catherine nes, former New York City Mayor h Giuliani, and former IBM CEO rstner have had club fittings at Call- test center.

ne Titleist facility last year, ex-CEO Blank of Home Depot showed up vo execs from the Atlanta Falcons, National Football League fran- team President Rich McKay and oach Jim Mora Jr. "It's not eight day of laughing and telling jokes," ora. "I was trying to lock in mental- ng to get better." Mora says he d his handicap to 13 from 17.

sts learn about more than their golf Titleist provides each player with n counseling and a comprehensive evaluation. Among the amenities is ervice gym with a practice putting "We're kind of the Mayo Clinic of ays Dave Phillips, co-founder of TPI espected teaching pro.

away's luxe experience focuses on swing flaws and giving each guest nald Trump treatment. Guests stay ur Seasons hotel, ride in stretch nd have every whim indulged. "If a ells us: 'I only eat Famous Amos ,' we send somebody out for them," says Randy Peterson, Callaway director of fitting and instruction. He's not so concerned about whipping guests into tip-top shape. "There's no correlation between doing more sit-ups and being able to play golf," he says.

Both golf meccas have a behind-the-scenes aura. Callaway's recently expanded performance center, which reopened June 27, is a two-story stucco cottage that includes the ultimate club workshop stocked with shafts, clubheads, and grips.

At 33 acres, compared with the 10-acre Callaway performance center, TPI is huge, featuring 10 tees, seven greens, and three fairways. A neat feature is the short game area, which boasts a humpback putting green that makes every putt an adventure and a British Open style pot bunker that adds a devilish touch. Until 2004, when Titleist opened the center to the public, the only visitors were company design engineers and touring pros tweaking their swings and equipment. The utilitarian feel of the structure prevails, though it now blooms with Birds of Paradise colorfully lining walkways and flowering pear trees in the parking lot.

TWO DAYS ON THE TOUR

LUXE EXPERIENCES hardly are a high-volume business for Titleist and Callaway. Titleist has only one TPI, near its club-production plant. Sessions generally are limited to groups of six golfers, often accompanied by their home club pro.

During a recent visit, I observed the facility in full, multi-use mode. At one end, TPI guests were gathered on a practice tee walloping drives as a Titleist club fitter looked on, taking notes on how to custom-fit the drivers he would be making for them later that day. At the other end, engineers were wandering a fairway. Every six or eight seconds, the clang-clang of "Iron Byron," the famous mechanical golfer, could be heard pounding the balls of a Titleist competitor into the morning sky.

Callaway officials say their sessions will be limited to four players, with a total of about 40 this year. "This is for the golfer who wants to be a tour player for two days," says Callaway's Peterson. Titleist makes it easy for guests to retain what they've learned. Information about their diet and fitness programs as well as their golf swings, including funky moving 3D images of the golfers in motion, are posted to the Web site (mytpi.com). You don't have to worry about images of your slice grip floating around cyberspace: Access to each golfer's profile is controlled by password. It can remain a secret forever, like your true handicap.

Taking the Cure

LEFT Each player's swing is analyzed by a computer, creating a 3D image guests can access later on TPI's Web site

TOP Stretching out in TPI's full-service gym. Guests are provided with a fitness evaluation and nutrition counseling

ABOVE TPI's Launch Monitor helps custom-fit new Titleist clubs to each player's size and swing

Trying to Sharpen Jaguar's Claws

The new XK is Ford's best Jag yet, but it's still not as much fun as its rivals. BY DAVID KILEY

SOMETHING MAKES SPORTS car enthusiasts care very deeply about Jaguar, the venerable British nameplate that has, alas, been owned by Ford Motor since 1990. For the brand that earned devotion with the sexy postwar XK-120 and iconic E-Type, the American ownership of Jag has been a good-news, bad-news affair. While Jag's quality, once a bigger joke than Richard Harris singing *MacArthur Park*, is now top-drawer, it's brand élan has never been worse. Sales of Jaguars have been plummeting recently and Jag hasn't helped its image by foisting a $30,000 front-wheel-drive compact sedan, the X-Type, on the public.

That brings us to the newest cat from Coventry with an assist from Dearborn, Mich. This sleek, curvaceous, burl-walnut bedecked, $80,000-plus new XK convertible is Ford's best attempt yet to restore to Jag the burn that has long been absent.

The XK shares underpinnings with another Ford-owned sports car, the $110,000-plus Aston Martin Vantage. Jag lifted the 4.2-liter 300-horsepower V8 engine from the XJ sedan. No surprise then, that the car purrs nicely at low speed and elevates to a throaty growl at higher revs.

As few of us get to drive any vehicle above 100 mph, what's important about this car is its design, interior appointments, and, of course, the admiration elicited when its driver pulls up at the boss's weekend house. The rear-quarter view of the XK is its most photogenic. The haunches of the convertible (the model I tested) really do remind me of a big cat hunkering down for a pounce. The burl walnut in the cockpit is masterful. Leatherwork on the seats, as expect in a Brit car, is as good as a Royce. Steering precision and br power exceed any Jag in recent me and are on a par with a Mercedes. A ple LCD touch-screen in the center dash that controls navigation, a temperature, and other functions wonderfully simple at first. But wi top down, readability washes awa sunshine, and it often took me mu jabs to change the radio station wheel-wells are a bit overgenerou that's to accommodate optional, g 20-inch wheels.

THAT FORD TAURUS SMILE

THE FRONT END is a bit too block it was designed to meet new Eur regulations intended to give pedes a better chance of survival if th plows into them. And Jaguar s change the vapid smiling grille re cent of the—egads!—Ford Taurus

The backseat held a booster se my preschool son. But I'd only sul suitcase, or Hummer owners who recycle, to the same. One glaring sion: a retracting hardtop tha rigueur among pricey convertible the Mercedes SLK. The cloth top, up, makes for a noisy cruise.

The XK is the start of a last effort by Ford to save the Jaguar by concentrating on stylish mod priced above $40,000. This strate be advanced with a new S-Type se 2008 and the decision to let the fade into the same dustbin as Moore's 007 films.

At bottom, the XK is a fun, styli that befits the heritage of the Jag bra those of us who still care. Still, amor vertibles, I find the BMW Z4, Me SLK, Audi S4, and even the Mazda more flat-out fun to drive, even don't have the same caché among sports car enthusiasts as the Jag.

SET TO POUNCE This cat has details worthy of the legacy brand

hâteau our Name Here

n grape to bottle, clubs and schools are helping inners become vintners. BY KRISTINA SHEVORY

MARK JONES HAD wanted to try his hand at winemaking for the longest time. But the Chicago-based marketing executive, who has ollecting wine for 15 years, simply ed he'd have to California, vineyard, and hire an expert con-. Then he discovered Crushpad. ough this San Francisco outfit that aspiring vintners through the s, Jones could make a barrel of or 300 bottles, for as little as). He went for the deluxe e, paying $9,000 for extra on from professional akers and cabernet sauvi- grapes from Napa-based oach Vineyard, which es high-end wineries is Caymus and Robert ineyards. "I said: 'Euere's my chance to make ithout investing millions of ,'" says Jones, 44.

e than 750,000 amateur vint- e producing their own vino na- de, according to *WineMaker ine*, and the number keeps grow- classes, clubs, Internet instruc- nd wine kits become more widely le. "Once you understand the s and start with good grapes, you ake pretty good wine," says Lapsley, adjunct professor of ure and enology at the Universi- lifornia at Davis.

grape to bottle, making wine can to two years. First, you need to de- the type. Reds are generally easier uce than whites because their col- he wood flavor they pick up while elp hide mistakes. Once you buy es, you crush them in a vat with nds or a crushing tool. Next, add start fermentation. The skins and ill float to the top and form a "cap" which has to be punched down regularly. Drain off the wine into a barrel or tank to age at least six months and bottle.

Over nearly two years, Jones flew to San Francisco about six times to Crushpad's 16,000-sq.-ft. warehouse to learn the winemaking process and to monitor his wine's progress. His cabernet sauvignon is still in barrel and should be ready for bottling this summer. He's so thrilled with the results he has tasted, he made a second barrel.

Even if you can't visit your wine in person, you can check its development via the Web. "Whether you're here or not makes no difference," said Michael Brill, who started Crushpad in March, 2004 (crushpadwine.com.)

If San Francisco is too much of a haul, chances are you can find a school closer to home. The Bacchus Winemaking Club in Toms River, N.J. (bacchusnj.com), will guide wannabe vintners for $1,100 a half barrel. If you have deep pockets and want the counsel of world-class vintners, you can join the Napa Valley Reserve, a members-only winery and vineyard in St. Helena, Calif., that Bill Harlan of Harlan Estate opened in 2004. Members make 72 to 900 bottles of cabernet sauvignon-based blends for $55 per bottle and have access to such special events as a tasting with wine expert Karen MacNeil. Membership is $150,000 plus $960 in annual dues (napavalleyreserve.com).

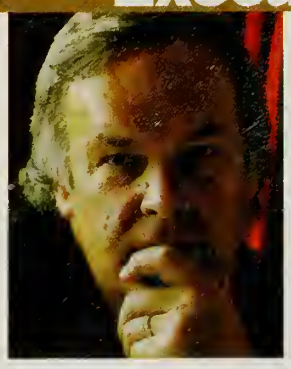
FORGET DANDELIONS

FOR THOSE WHO just want to dabble, winemaking kits have improved over the past few years and now offer Australian shiraz, Italian pinot grigio, and German riesling in addition to other varietals. The kits, for $50 to $125 from Winexpert and Vincor, among others, contain pure grape juice or concentrate, yeast, and additives required to make five to six gallons of wine. You also have to spend around $150 to buy equipment, including a fermenter.

Wine publications don't rate amateur wines, but *WineMaker* publisher Brad Ring says "the top-tier stuff rivals the better commercial wines I've had. It's not the dandelion wine of the past."

BusinessWeek online For a winetasting that put an amateur pinot noir up against four from the pros, go to businessweek.com/extras

BusinessWeek Weekend To see amateur winemakers in action, tune in to *BusinessWeek Weekend*. Check your local listings for details.



BY ROBERT PARKER

An Artist Who Works in Grapes

PAUL HOBBS, ONE OF CALIFORNIA'S leading winemakers, offers full-bodied, intensely concentrated wines, in part because he bottles them without filtration or fining, processes commonly used to remove sediment that ca also remove flavor. Hobbs started his career as a wine consultant 20 yea ago in Argentina, where he still produces wines under the Los Cobos an Marchiori labels. Here are some of my favorite Paul Hobbs wines:

Pinot Noir Russian River Valley 2003
89 points. From a challenging vintage, shows a deep ruby/purple-tinged color, elegant plum, cherry, and anise notes, medium body, and a lusty, heady finish. Drink in three to four years. $40

Chardonnay Russian River Valley 2004
90 points. Offers up notions of citrus oil and white peaches in a medium-bodied, elegant, refreshing style with great fruit as well as subtle wood. Enjoy it over the next two to three years. $40

Chardonnay Richard Dinner Vineyard 2003
94 points. Hints of orange marmalade, crushed rocks, honeyed apple skins, and pineapples along with a huge texture, full body, and good underlying acidity. $55

Chardonnay Ulises Valdez Vineyard 2004
95 points. Boasts a wonderful leesy/brioche character intermixed with honeysuckle, orange rind, tangerine, and hazelnut. With great fruit, full body, superb intensity and concentration, it should drink well for five to six years. $55

Merlot Michael Black Vineyard 2003
93 points. The final vintage for this wine. Shows off a dense purple color plus a sweet perfume of espresso, white chocolate, black cherries, and figs. With tremendous opulence, density, and a long, lush finish, it will provide plenty of pleasure anytime over the next decade. $65

Cabernet Sauvignon Napa Valle 2003
93 points. A dark ruby/purple-colored, f bodied, impressively endowed effort offer notes of charcoal, smoke, crème de cassi toasty oak. A wealth of glycerin, concentr and fruit suggest it will provide ideal drink now and over the next 10 to 15 years. $65

Bramare Marchiori Vineyard 20
93 points. This sensational malbec, fro Hobbs's Argentine winery, offers jammy blackberry notes, a touch of smoky oak, a full-bodied, velvety texture. $85

Cabernet Sauvignon Dr. Crane Vineyard 2003
95 points. This 100% cabernet sauvign boasts tremendous fruit and ripeness alc with hints of graphite, espresso roast, blackberries, crème de cassis, and spice rich, concentrated, prodigious effort shou enjoyed between 2008 and 2020+. $100

To find Paul Hobbs wines, call 707 824-9 send an e-mail to info@paulhobbs.com.

Visit **www.eRobertParker.com** for th Internet's most active wine bulletin b tens of thousands of tasting notes, o order his recent book, *The World's Greatest Wine Estates: A Modern Perspective*. You can also subscribe t Parker's newsletter, *The Wine Advoca* Request a sample copy at: *The Wine Advocate*, P.O. Box 311, Monkton, MD

Wines rated from 96-100 are extraordinary; 90-95, excellent; 80-89, above average to very good. For more Parker picks, go to businessweek.com

TED BY MONICA GAGNIER

LD'S PLAY

DEGREE IN IPPING ON BANANA PEEL?

SIDE, BOZO. On June 16, Ringling & Barnum & Bailey opened a college for children 3 to 14 at ado City, an indoor amusement n Sunrise, Fla., where kids can te professions such as pizza baker ne investigator. Would-be clowns an participate in activities ranging tilt walking and juggling to slapstick and pantomime, included in the $7.95-$29.95 admission price to Wannado. In-depth clown lessons are saved for five-day camps starting on July 10 and July 24 ($300, www.wannadocity.com). Wannado opened in 2004 s since seen at least 1.2 million , says Rene Aziz, the chief ve. Aziz plans to open a similar ith a clown college in East ford, N.J. *–Greg Hafkin*

COLLEGE
s range from stilt g to pantomime

MUSIC

His Master's Bytes

THESE NEW CLASSICAL MUSIC PRODUCTS may strike a chord with fans. Fortuna Classical Music of San Diego has compiled 5,000 classical recordings into one digital catalog called the Cornerstone Collection. Fortuna co-founder Ross Stensrud was inspired after he saw how his father struggled to get information about classical works into his music player. Stensrud's solution? Music lovers send Fortuna their collection to be digitized and catalogued onto Fortuna's Maestro digital music player. The Cornerstone Collection and Maestro (including the digital transfer) can be bought together for $4,995 at fortunaclassical.com.

Music editor and critic Ted Libbey has compiled the *NPR Listener's Encyclopedia of Classical Music*, with 1,500 entries on all things classical from Marian Anderson and Richard Wagner to an enlightening description of the glockenspiel. The price—$19.95 in paperback and $29.95 for hardcover—grants access to a companion Web site featuring more than 500 musical selections highlighted throughout the text. You can read about your favorite composer as you listen to the work. *–Sophia Asare*

E OFF

JULY 4 WEEKEND will be wild indeed at the opening of the Center/Natural History Museum of the Adirondacks in Tupper N.Y. The $25 million center features a river, populated by live als such as otters and turtles, that runs through its 12,000-e-foot main hall. The July 4 WildFest will feature an outdoor stocking, tree plantings, and an interactive children's er (wildcenter.org). *–Nichola Saminather*

RETREATS

MAYBE THEY DO CAVIAR FACIALS

WITH THE DEBUT of two spas in the Northeast, some people may be tempted to stay off the beach this summer. The Lodge at Woodloch, which opened June 26 in Hawley, Pa., on 75 wooded acres with a private lake, is the first new luxury destination spa in the region since Canyon Ranch came to Lenox, Mass., in 1989. Rates start at $575 per night (thelodgeatwoodloch.com). The other spa is an addition to the Mayflower Inn, a super-luxe hotel in Washington, Conn. A five-night spa stay starts at $6,700 per person (mayflowerinn.com). *–Kristin Dew*

Must-Reads for Investors

We asked dozens of pros what they pull off the shelf again and again. **BY CHRISTOPHER FARRELL**

When I got my first job covering financial markets in the early 1980s, I didn't know a thing about stocks and bonds, an inconvenient fact I failed to mention to the editor who hired me. In something of a panic, I called an acquaintance who had a PhD in economics and a high-paying job on Wall Street. "What should I read?" I asked. "Two books," he said. "That's all you'll need." His recommendations were *A Random Walk Down Wall Street* by Burton Malkiel and *The Only Investment Guide You'll Ever Need* by Andrew Tobias. I've read dozens of finance and economics books since then, but those two have always stood me in good stead.

Of course, the investing world has changed vastly in the interim. Back then, 401(k)s didn't exist, let alone online trading, exchange-traded funds, and the ability to buy stock in Russian and Chinese companies. Just 13% of Americans owned stocks in the early '80s; now more than half the population does.

We asked dozens of professional investors what books they think will best serve the individual investor today. What tomes do they turn to for inspiration, guidance, and understanding? What authors have stood the test of time? "You want books that give some perspective about managing wealth over the long term," says Andrew Lo, finance economist at Massachusetts Institute of Technology's Sloan School of Management. "That's the single biggest challenge for an aging population today."

Against the Gods: The Remarkable Story of Risk

By Peter Bernstein (Wiley)

RISK IS A RICH word with many shades of meaning. How much financial risk are

you willing to
What risks d
want to avoid?
stein, the dean
nance econ
and a philosop
risk, publishe
1996 this fasci
history of the
cept and how m
ing risk is the e
of investing. "The revolutionary id
defines the boundary between m
times and the past is the mastery o
the notion that the future is more th
whim of the gods and that me
women are not passive before na
writes Bernstein. For example, i
chapter he eloquently details how
laureate Harry Markowitz, while a
ate student at the University of Ch
mathematically illustrated the po
diversification to lower risk and in
returns, and why it's the "nearest
vestor can ever come to a free l
Bernstein manages to bring the
stract notions to life.

Extraordinary Popular Delusions an The Madness of Crowds

By Charles MacKay (Harriman House C

AH, IF ONLY MORE investors ha
this during the heady dot-com
They might not have lost their ne
in eToys or online grocer Webvan
First published in 1841, MacKay's
a powerful portrayal of those times
investors abandon reason and su
to mass mania, e.g., tulipmania i
century Holland. In the preface
1932 version, the famous in
Bernard Baruch captures the book
it by quoting the poet Friedric
Schiller: "Anyone taken as an indi
is tolerably sensible and reasonabl
member of a crowd, he at once bec
blockhead.'"

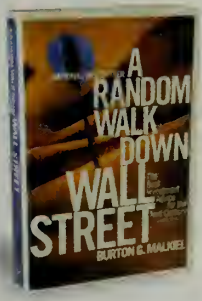
A more modern classic, originall
lished in the late 1970s, is *Manias,*
and Crashes: A History of Financial
5th Edition by Charles Kindleberg
Robert Aliber (Wiley Investment
sics). In this latest edition, Kindle
with the help of international eco
Aliber, deals with a number of late
price bubbles, such as the Japanes
omy in the 1980s and the tec
boom of the 1990s. "By reading i
see the extent to which human
doesn't change, especially when it

emotion that tends to drive invest- l speculating and fear and greed," lward Yardeni, chief investment of- Oak Associates, an Akron invest- rm.

om Walk Down Wall Street, tion

on Malkiel (W.W. Norton)

s classic, first published in 1973, on University's Malkiel translates untitative, highly abstract insights dern finance into everyday ge. He taps olorful vein of al history to live the capi- kets. Malkiel that in this ely competi- bal arena, try- eat the mar- fool's game azardous to your wealth. Instead, ntra is diversify and invest in in- ds.



ast part of the book is a practical guide to managing money, covering everything from limiting Uncle Sam's take to evaluating choices in the fixed-income markets. "It separates all the hype about money managers doing better using evidence that many of them don't, and that you really have to pay attention to fees when you look at your portfolio," says Jeremy Siegel, finance professor at the Wharton School.

Investment Policy: How to Win the Loser's Game, 4th edition

By Charles Ellis (McGraw-Hill)

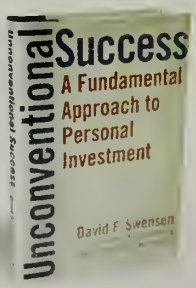
A LONGTIME consultant to institutional investors, Ellis distilled a lot of experience for individual investors in this book, which was first published in 1988. He uses a number of analogies to explain his investment philosophy, including tennis. He argues that you win in tennis by not making a mistake, by keeping the ball in play until your opponent errs. The same holds for investing.

Ellis' counsel: Stay calm. For instance, he writes: "History teaches that both investment managers and clients need help if they are to hold successfully to the discipline of long-term commitments. This means restraining themselves from reacting inappropriately to disconcerting short-term data and keeping themselves from taking those unwise actions that seem so 'obvious' and urgent to optimists at market highs and to pessimists at market lows." Says Percy Bolton, a certified financial planner and head of Percy E. Bolton & Associates in Pasadena, Calif.: "It talks about time, risk and return, and it's not technical."

Unconventional Success: A Fundamental Approach to Personal Investment

By David Swensen (Free Press)

SWENSEN, chief investment officer for Yale University's endowment, is a financial legend for the somewhat unorthodox investments and strategies he used to make Yale the most successful university investor in the nation. That includes minimizing holdings in U.S. stocks



and bonds and reallocating dollars to foreign equities, real estate, and alternative investments such as private equity, timber, and other commodities.

Swensen warns individual investors not to try this on their own. He argues that they just don't have the information flow and access to those markets to do so successfully. Nor does he believe that actively managed mutual funds can do the same for investors.

Instead, his advice is similar to Malkiel's: Invest for the long haul, own index funds, and keep your expenses low. "Swensen focuses the reader on the factors that truly make a difference in accumulating wealth over the long run as opposed to the vague and ineffective stockpicking rules featured in most other books," says Martin Fridson, a longtime investment professional and financial author himself.

Stocks for the Long Run

By Jeremy Siegel (McGraw-Hill)

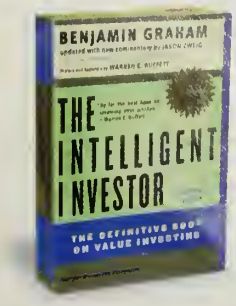
SIEGEL HAS since written a number of other important investing books, but this 1994 effort is still one of the best introductions to the pluses and minuses of investing in stocks over long periods. He is at his most persuasive when examining stock and bond returns since 1802. He explains the power of the equity risk premium—the extra return investors get for taking the risk of investing in stocks.

"Siegel makes a good case that stocks are a broad asset class to own for the future," says economist Bradford DeLong at the University of California at Berkeley. You may look to Siegel's analysis for comfort during those dark times when the Dow Jones industrials take a dive.

The Intelligent Investor: The Definitive Book on Value Investing, Revised Edition

By Benjamin Graham with Jason Zweig (Harper Business Essentials)

GRAHAM'S MOST famous acolyte is Warren Buffett, perhaps the greatest stockpicker of the past half-century. Buffett calls *The Intelligent Investor* a must-read. First published in 1949, it was reissued in 2003 with commentary on each chapter by *Money* Senior Editor Zweig, taking into account new investments and markets.

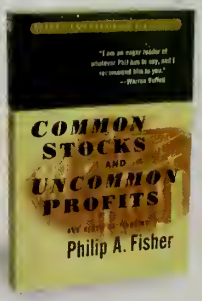


One of Graham's most powerful concepts is investing with the discipline of a "margin of safety." That's why he advocates buying companies only if you can do it for less than two-thirds their net asset value; that way you get some protection against unforeseen setbacks. He also focuses on stocks selling at prices that are low relative to companies' cash flow, another way to create a margin of safety. "It's absolutely the foundation for every investor, and Benjamin Graham is the father of intelligent investing," says Peter Bernstein. "You don't begin without that. It was the first book that was given to me when I entered the business."

Common Stocks and Uncommon Profits

By Phillip Fisher (Wiley)

PHILLIP FISHER is to growth investors what Benjamin Graham is to value investors. He started out in the investment business in 1928 and four years later founded his own investment advisory firm in San Francisco. He published this book in 1958, and it was the first investment book to make *The New York Times* best-seller.



Fisher was a s picker who aim own companie the long haul sought to cl those with the long-term gr prospects. He f companies tha low-cost produc their industry, with a manage dedicated to maintaining high margins.

What distinguishes Fisher from others is his emphasis on qualitativ tors rather than just the number spends a lot of time sizing up ma ment, zealously pursuing "scuttle by talking with vendors, suppliers other people familiar with a com "The first time I read it was 15 ago," says Ross Levin, a certified fin planner and head of Accredite vestors. "I keep 10 books that I am stantly getting down to reread, and one of them."

–*With Greg E*

STARTING OUT

Smart Gifts for Grads

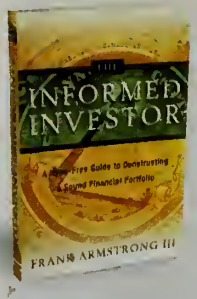
WHAT INVESTMENT BOOK should you give to a person who just out of college or to anyone who doesn't know a stock fro a bond from a mutual fund? These two fit the bill:

The Only Investment Guide You'll Ever Need

By Andrew Tobias (Harvest Books)

THE ADVICE is solid, and Tobias is an entertaining writer and storyteller. First out in 1978, the book has been revised several times, most recently in 2005. The latest version, for instance, deals with online investing, which didn't exist when the earliest ones were published.

"The advice I personally give a young person is: 'Don't carry a credit-card balance; put as much money in your IRA and 401(k) as you can,'" says Nell Minnow of watchdog The Corporate Library. "That comes from that book." Sure, a lot of what Tobias offers is common sense. But as all of us with grey hair and thicker middles know, it's often the hardest counsel to take.



Informed Investo

By Frank Armstron (American Management Assn

ARMSTRONG h had a busy caree former pilot, then sold insuran became a brol and, eventually, independent investment adviser.

This is a bread-and-butter bo and there's nothing elegant about language. Armstrong detests W Street's steep commissions and h fees. He offers no-nonsense advice evaluating mutual funds and c structing a portfolio. And there good discussions of compound int est, dollar-cost averaging, limit taxes, and balancing risk and rewa

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BY GENE G. MARCIAL

WHY SOME BIG OIL COMPANIES MAY BE EYEING DEVON ENERG

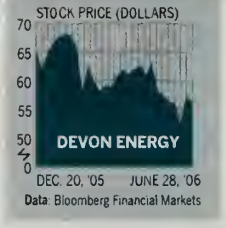
SOUTHERN COPPER ISN'T LIKELY TO STAY DEPRESSED FOR LON

CLINICAL TRIALS FOR ACUSPHERE AREN'T AS BAD AS THEY SEI

Pickings in the Oil Patch

DEVON ENERGY (DVN) could well get snapped up soon, as takeovers spread in the oil patch. Logical buyers for the top independent U.S. oil-and-gas producer might be Exxon Mobil, BP, or Chevron, says Fadel Gheit, oil guru at Oppenheimer. He rates Devon a "buy" on fundamentals as well as its appeal as a target. Devon itself has been busy purchasing companies such as Ocean Energy and Chief Holdings. That just adds to its allure by increasing its growth potential, assets, and valuation, says Gheit. Devon could be worth $40 billion, or 90 a share, vs. its price of 56.27 on June 28, he figures. Gheit notes that rival Kerr-McGee was also acquisitive before Anadarko Petroleum bought it in an all-cash deal on June 23. Arnold Schmeidler of investment adviser A.R. Schmeidler, which owns shares, also sees a buyout. The terms of the Kerr-McGee deal, he says, make Devon significantly undervalued. And its current cash flow of $6 billion, or $15 a share, makes Devon very attractive, as do its reserves of 2 billion barrels of oil equivalents, which Gheit values at $15.50 per barrel. The reserves, 58% in gas and 42% in oil, lie mostly in Texas, New Mexico, and Gulf of Mexico. Devon also operates in Egypt, China, Azerbaijan, Brazil, and Canada. "Devon is the cheapest in its group," says Gheit. It trades at eight times his 2006 earnings estimate of $6.54 a share, vs. nine for rivals. For 2007, he expects $8.61.

NOT SO ENERGETIC

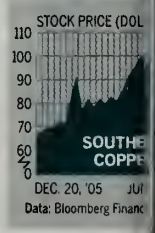


Data: Bloomberg Financial Markets

What's Polishing Up Southern Copper

SOUTHERN COPPER (PCU) WAS A SURPRISE beneficiary of Phelps Dodge's $21.1 billion offer on June 16 to buy nickel miners Inco and Falconbridge. How so? "The move by Phelps reaffirms our belief that the shine in metal prices will last much longer than many expect," explains Carl Birkelbach of Birkelbach Investment Securities. He also thinks Southern is potential takeover bait. It had dropped from 105 a share on May 11 to 70 in mid-June but, in the wake of the Phelps news, rebounded to 84.43 on June 28. Birkelbach, who likes to buy when companies are facing setbacks, stocked up after the shares fell below 100. Now he expects Southern, which produces copper in Peru and Mexico, to hit 110 as copper prices recover from their recent decline. "Southern's robust 15% dividend yield is a come-on," he adds. Most analysts have shied away from Southern because of a strike at its Mexican mines, which produce 50% of its copper. Even so, the stock still "looks compelling," says Daniel Altman of Bear Stearns. He rates Southern "outperform" with a yearend target of 125, based on the "scarcity value" of copper stocks, the "robust dividend," and the sound fundamentals.

OUT OF A TROUGH

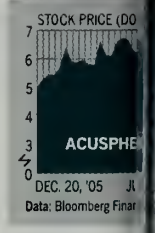


Data: Bloomberg Financ

Pounce on Acusphere While It's Down?

ACUSPHERE (ACUS) TOOK A DIVE on June 6, wh announced mixed results from trials of a new pr The stock, which stood at 5.64 on June 5, fell to June 28. Some analysts spy a chance to buy. The produ Phase 3 clinical trials is AI-700, an ultrasound contrast aimed at better diagnosis of heart disease. It lets docto at blood flow within the heart muscle, a use for which duct has yet been approved. AI-700 passed only two of three tests in the Phase 3 trials. "The stock is oversold," says David Moskowitz of Friedman, Billings, Ramsey, who rates it "outperform" with a 12-month target of 12. Investors ignored the "highly positive accuracy and specificity results in the [first part of the] trial," says Moskowitz. And the market is acting as if AI-700 won't get Food & Drug Administration approval, but that isn't so, says Deborah Knobleman of investment firm Piper Jaffray who tags it a "buy." She expects the part of the trials to show more favorable results. So do Alexandra H. Utterman, senior analyst at investment b William D. Witter, which owns shares. The stock is "ov and trading way below its intrinsic value," she says.

THE PRESS IS OFF



Data: Bloomberg Finar

BusinessWeek online Gene Marcial's Inside Wall Street is po businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street firms hold positions in the stocks under discussion. Similarly, they have no in banking or other financial relationships with them.

) Blue Chips in one package. Brilliant.

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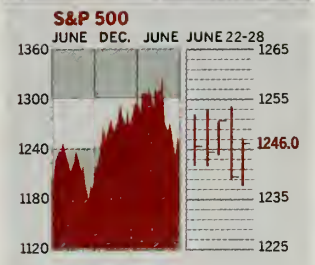
Personal Finance Figures of the Week

STOCKS



COMMENTARY

The markets were desultory as investors braced themselves for expected interest-rate hikes by the Federal Reserve. After a dramatic sell-off, stocks regained some ground led by the energy, utility, and banking sectors. The Dow Jones industrial average slumped 1%. Mortgage applications slid to a four-year low, and oil rose to $72 a barrel.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	JUNE 28	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1246.0	-0.5	-0.2	3.7
Dow Jones Industrials	10,973.6	-1.0	2.4	5.5
NASDAQ Composite	2111.8	-1.4	-4.2	2.0
S&P MidCap 400	729.2	0.1	0.2	7.7
S&P SmallCap 600	360.7	-0.2	2.9	8.5
DJ Wilshire 5000	12,518.2	-0.4	0.2	4.8
SECTORS				
BusinessWeek 50*	707.5	-0.2	-4.6	-0.7
BW Info Tech 100**	364.2	-1.4	-4.3	2.7
S&P/Citigroup Growth	576.4	-0.7	-3.4	0.3
S&P/Citigroup Value	667.9	-0.2	3.1	7.2
S&P Energy	410.3	5.7	10.1	18.0
S&P Financials	426.8	-0.7	0.1	7.4
S&P REIT	164.6	-0.3	7.5	10.3
S&P Transportation	275.4	0.2	10.2	32.1
S&P Utilities	161.3	0.1	1.0	0.5
GSTI Internet	169.4	-2.5	-17.4	4.2
PSE Technology	767.0	-2.7	-8.3	2.1

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	JUNE 28	WEEK	% YEAR T DATE
S&P Euro Plus (U.S. Dollar)	1587.9	-1.4	5.
London (FT-SE 100)	5678.6	0.2	1.
Paris (CAC 40)	4774.0	0.0	1.
Frankfurt (DAX)	5456.9	-0.8	0.
Tokyo (NIKKEI 225)	14,886.1	1.7	-7.
Hong Kong (Hang Seng)	15,742.7	0.5	5.
Toronto (S&P/TSX Composite)	11,332.3	2.0	0.
Mexico City (IPC)	18,101.8	-0.3	1.

FUNDAMENTALS	JUNE 27	WEEK AGO
S&P 500 Dividend Yield	1.91%	1.90%
S&P 500 P/E Ratio (Trailing 12 mos.)	16.6	16.7
S&P 500 P/E Ratio (Next 12 mos.)*	13.9	13.9
First Call Earnings Revision*	1.33%	0.77%

TECHNICAL INDICATORS	JUNE 27	WEEK AGO
S&P 500 200-day average	1261.8	1261.5
Stocks above 200-day average	43.0%	40.0%
Options: Put/call ratio	0.80	1.00r
Insiders: Vickers NYSE Sell/buy ratio	3.06	3.29

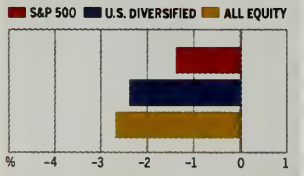
BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Oil & Gas Storage	7.5	Steel	125.0
Drug Chains	6.0	Agricultural Products	88.6
Spclzd. Cnsmr. Serv.	5.6	Divsfd. Metals & Mining	62.6
Motorcycles	4.4	Employment Services	55.9
Diversified REITs	4.4	Railroads	53.7

WORST-PERFORMING GROUPS	LAST MONTH %	
Electric Mfg. Svcs.	-16.4	Educational Services
Tires & Rubber	-14.6	Homebuilding
Divsfd. Metals & Mining	-11.6	Tires & Rubber
Homebuilding	-11.5	Automobiles
Employment Services	-11.3	Home Entertainment

MUTUAL FUNDS

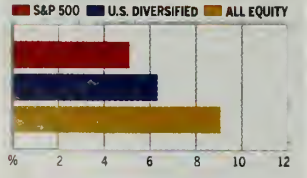
4-WEEK TOTAL RETURN

WEEK ENDED JUNE 27



52-WEEK TOTAL RETURN

WEEK ENDED JUNE 27



Data: Standard & Poor's

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Utilities	0.8	Precious Metals	59.6
Real Estate	0.6	Latin America	41.3
Domestic Hybrid	-1.5	Natural Resources	29.2
Large-cap Value	-1.6	Diversified Emrg. Mkts.	27.4
LAGGARDS		LAGGARDS	
Precious Metals	-7.5	Health	0.9
Diversified Pacific/Asia	-6.8	Large-cap Growth	3.1
Japan	-6.5	Domestic Hybrid	3.8
Diversified Emrg. Mkts.	-6.3	Technology	4.8

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
DireXn. Dvpd. Mkts. Bear 2X	10.5	U.S. Global Invrs. Gold	96.4
ProFunds USh. Intl. Inv.	10.4	Midas	96.4
DireXion Emrg. Mkts. Sht.	10.1	U.S. Glbl. Invs. Prc. Mnls.	88.2
ProFunds UltSh. Jap. Inv.	7.7	ING Russia A	80.7
LAGGARDS		LAGGARDS	
Ameritor Investment	-25.0	Ameritor Investment	-75.0
iShares Silver Trust	-20.5	American Heritage Grth.	-33.3
The Rational Investor	-16.0	Frontier MicroCap	-21.7
DireXn. Emrg. Mkts. Bl. 2X	-15.7	Alpine U.S. Rl. Est. Eq. Y	-20.8

INTEREST RATES

KEY RATES	JUNE 28	WEEK AGO
Money Market Funds	4.62%	4.57%†
90-Day Treasury Bills	4.99	4.91
2-Year Treasury Notes	5.28	5.20
10-Year Treasury Notes	5.25	5.16
30-Year Treasury Bonds	5.28	5.19
30-Year Fixed Mortgage†	6.76	6.67

†Banx

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	3(
General Obligations	4.23%	
Taxable Equivalent	6.04	
Insured Revenue Bonds	4.26	
Taxable Equivalent	6.09	

THE WEEK AHEAD

VEHICLE SALES *Monday, July 3* » June sales of light vehicles most likely rebounded to an annual rate of 16.5 million units, according to *WardsAuto.com*. Sales in May fell to a pace of 16 million vehicles.

PURCHASING MANAGERS' INDEX *Monday, July 3, 10 a.m. EDT* » The Institute for Supply Management's June factory activity index is forecast to have edged up to 55%. That's the median forecast of economists surveyed by Action Economics. The May reading slipped to 54.4%.

CONSTRUCTION SPENDING *Monday, July 3, 10 a.m. EDT* » Building outlays in May probably grew 0.3%. In April, outlays eased 0.1%. A 1.1% fall in the residential sector mitigated the 2.5% jump in private nonresidential spending.

FACTORY INVENTORIES *Wednesday, July 5, 10 a.m. EDT* » Manufacturing inventories most likely rose by 0.3% in May. Stockpiles of durable goods were already reported to have risen 0.4%. Factory inventories jumped 0.7% in April.

EMPLOYMENT *Friday, July 7, 8:30 a.m. EDT* » Nonfarm payrolls are expected to have risen by 165,000 workers in June, after a smaller-than-expected increase of 75,000 jobs in May. The jobless rate most likely held at 4.6%. Hourly earnings probably picked up the pace with a 0.3% gain.

The *BusinessWeek* producti improved to 281.9 for tl ended June 17, a gain of 15.1 year ago. Before calculatic four-week moving average, eased back to 281.

BusinessWeek o

For the BW50, more inves data, and the component of the production index, v www.businessweek.com/extras

ompany Index

dex gives the starting page for a story or feature with a cant reference to a company. Most subsidiaries are indexed under wn names. Companies listed only in tables are not included.

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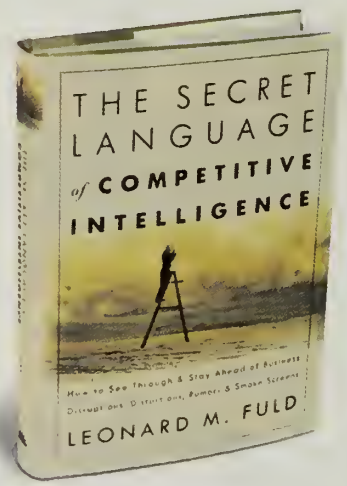
Reading Your Rival's Mind

THE SECRET LANGUAGE OF COMPETITIVE INTELLIGENCE How to See Through & Stay Ahead of Business Disruptions, Distortio Rumors & Smoke Screens
By Leonard M. Fuld; Crown Business; 309pp; $24.95

Remember when Larry Ellison went digging through Bill Gates's garbage? Well, actually, it was a tad more complicated: In 2000 detectives hired by Oracle rummaged through the trash of a pro-Microsoft organization. And there was a similar brouhaha a year later, when Procter & Gamble admitted that employees had hired investigators to rifle through Unilever's rubbish for shampoo secrets.

These kinds of activities may reflect the common image of corporate intelligence-gathering. But true "competitive intelligence" (or CI, as it's often called), at least as practiced in most corporations, is hardly so cloak-and-dagger. Typically the purview of the strategy department, CI is a legal and essential corporate function that involves collecting and analyzing often public but little-noticed information about rivals.



In fact, it's so important that CI shouldn't simply be left up to the pros, says Leonard M. Fuld, one of the pioneers of the field. In *The Secret Language of Competitive Intelligence: How to See Through & Stay Ahead of Business Disruptions, Distortions, Rumors & Smoke Screens*, Fuld argues that competitive intelligence should be the job of all employees. Fuld's firm, which was founded in 1979, has worked with more than half of the 500 largest companies in the U.S., and he also runs an academy to teach the discipline. *Secret Language* is his nuts-and-bolts guide for the uninitiated. And although it's sometimes repetitive and a bit simplistic, the book is an accessible and practical handbook for reframing the way you think about your competitors.

The author's basic training utilizes both generic tools and advice and ideas from CI practitioners. For instance, Fuld describes the technique of Dale Fehringer, a former CI executive at Visa International. Fehringer would often scan ads and news clippings about rivals that he'd spread over his kitchen table, searching for faint, almost hidden patterns that might indicate their strategies. Another practitioner who recommends careful, skeptical study of competitors' public info is Mark Higgins, an intelligence-gatherer for Novartis. Oftentimes, says Higgins, when a rival is writing and talking a lot about a drug compound, the product is probably less of a priority than something they are trying to keep secret.

In addition to information gathering, it's useful if you can put yourself inside competitors' heads. That's where war games come into play. Fuld tells how a group of Harva and Massachusetts Institute of Technology MBA stude enacted a mock "Battle for Clicks" between Google, Microsoft, AOL, and Yahoo!. The students were divide teams representing the four companies and then thro scenario curveball, to which they had to react. Reader uninterested in the online search world may find this s overly detailed, but the exercise is a helpful illustratio how to anticipate rivals' thinking.

In another chapter, Fuld lays out several practical "I X-Ray concepts." One of these involves sifting through anonymous job postings for rivals' "corporate DNA," o snippets of jargon companies characteristically employ to describe themselves. For instance, IBM often u phrase "We strive to lead in the inven development and manufacture of the industry's most advanced informatio technologies," says Fuld. When you t you detect such language, you can sin copy and paste it into Google. A resul search might confirm that an otherwi unidentified company is looking for a expert in an entirely new line of busin

Like many management books, *Se Language* is redundant in places. An era when companies have tools that integrate feeds from blogs and Web sophisticated industry-analysis repo and complex corporate dashboards t track every imaginable metric, this b sometimes feels pretty b

Competitive intelligence should be the job of all employees, Fuld argues

Another gripe: Parts o chapter "Competitive Fo which describes how fam business leaders gather intelligence, seem a little point. We read how Sam Walton and Michael Dell placed a high priority on supplier and customer intelligence—but that's different from getting a s on your rivals. In the san chapter, an imaginary Q Fuld concocts with Nathan Rothschild, the 19th centu banker who capitalized on Napoleon's defeat at Wate downright irritating.

All the same, *Secret Language* is a handy guide for managers trying to dope out competitors' next moves. a good reminder that there's a better way than rumma through other companies' trash cans.

–By Jena M

The BusinessWeek Best-Seller List

HARDCOVER BUSINESS BOOKS

	LAST MONTH	MONTHS ON LIST
THE WORLD IS FLAT Thomas L. Friedman (Farrar, Straus & Giroux • $30) *Globalization is great—sort of, says a columnist* rom The New York Times.	1	13
FREAKONOMICS Steven D. Levitt, Stephen J. Dubner (Morrow • 25.95) *Crack gangs, the Ku Klux Klan, and more, examined y a University of Chicago economist.*	3	14
BLINK Malcolm Gladwell (Little, Brown • $25.95) *Snap* udgments deserve careful consideration, says a writer for The ew Yorker.	4	17
THE LITTLE RED BOOK OF SELLING Jeffrey Gitomer (Bard Press $19.95) *Why people buy.*	7	21
THE LITTLE RED BOOK OF SALES ANSWERS Jeffrey Gitomer Prentice Hall• $19.99) *"Fatal flaws" of selling and more.*	6	3
JIM CRAMER'S REAL MONEY James J. Cramer (Simon & chuster • $26) *A trading methodology from CNBC's ild man.*	5	14
SECRETS OF THE MILLIONAIRE MIND T. Harv Eker HarperBusiness • $19.95) *Shape your financial destiny.*	10	14
THE LITTLE BOOK THAT BEATS THE MARKET Joel Greenblatt Wiley • $19.95) *The basics of "value investing" by a Wall treet veteran.*	8	6
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8	**LEADERSHIP AND SELF-DECEPTION** The Arbinger Institute (Berrett-Koehler • $14.95) *A leader's motivation is what matters, says this business fable.*	—	3
9	**RICH WOMAN** Kim Kiyosaki (Rich Press • $18.95) *How women can take control of their finances.*	—	1
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nd more are available on **AOL** (Keyword: BW) or **www.businessweek.com**

IdeasFaceTime
WITH MARIA BARTIROMO

Summers' Storm Warning

IN THE SAME WEEK that Warren Buffett donated $31 billion to the Bill & Melinda Gates Foundation, Oracle announced that CEO Larry Ellison will not give more than $100 million to Harvard. The subtext: He doesn't like the way the ultimate Ivy treated its outspoken and outgoing president, Larry Summers. You'd think that being forced out of Harvard, which Summers will exit on June 30, would send anyone into a funk. But the former Treasury Secretary (under Bill Clinton), who married about a year ago, seems as happy as a schoolboy heading into summer vacation.

SUMMERS Man in a hurry

How do you see the economy playing out?
The end of this expansion is not in sight, [but] there is a gathering constellation of risk. The major risks include price inflation, asset deflation in the housing market, and the risks associated with our substantial dependence on foreign capital and oil imports from less-than-stable parts of the world. All of this means that negative surprises are more likely over the next year than in the typical year.

Is the economy on the verge of higher inflation, requiring more Fed hikes, or do you anticipate a weakening in the second half that would cool inflationary pressures?
I think the Fed is trying to navigate its way across a very narrow ledge on a fairly high precipice. [Below are] the risks of a slowdown and housing problems on the one hand and inflation on the other. It will take both very [precise] readings of the economy and good luck for us to come through smoothly over the next year and a half.

Given the continued large budget and current-account deficits, what could trigger a sharp drop in foreign financing of the U.S. economy? And how imminent is this?
It's very difficult to judge, not least because so much of the financing is coming from the foreign governments through their central banks, so their decision-making is guided by much more than a currency trader's calculation of profit and loss. What is clear is that we are taking needless risks with th nitude of our dependence on foreign capital, given t debts are financing consumption rather than investme

What would you do to boost revenues?
We need to look at overall fiscal policy, both in terms of cuts, the long-term context of entitlement problems, questions of growing inequity in the distribution of inco can't continue to cut taxes and increase spending in the have over the past six years. The combination of mor more butter, and more tax cuts is not sustainable.

Hank Paulson as Treasury Secretary: Good choice?
I am proud that another Harvard B School alum is becoming the Treas retary. Hank is an extraordinarily spected and experienced financial And I think it is good at a time w risk of financial instability is p higher than normal to have someo his breadth and depth of experien

Are you worried about the twin defi
I am not one who believes in fore apocalypse from the deficits, but fiscal policy is running a needless you smoke a pack or two a day, it necessarily hurt your health, but i risk a prudent person takes ... so a our budget deficits.

Why are people so nervous about the global markets?
I think there is a growing awareness that there are sub risks.... As the old joke goes, the three most dangerou on a ski slope are: Follow me dad. And the four most dangerous words in markets are: It's different this tim

What happened at Harvard?
I was a man in a hurry with a strong desire to bring abo I thought were important changes in the university's commitment to science and technology, to using its res for financial aid, to supporting public service, and espe increasing the faculty commitments to undergraduate students at a time when a growing fraction of teaching grading was done by graduate students. All of that, plu doubt some mistakes I made, created a great deal of tur in what has been a rather tradition-bound institution.

Maria Bartiromo is the host of CNBC's Closing Bell.

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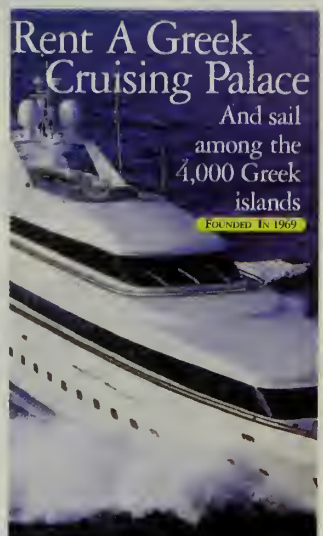

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Ideas The Welch Way

BY JACK AND SUZY WELCH

The Danger of Doing Nothin

Five years ago we started a company in the then-red-hot fiber communication industry. We've fought hard to stay viable, but now it's obvious that the "growth space" for our company is much more limited than we'd hoped for. Should we give up and start again in a new area or stay in the survival game?

–Ling Chen, Sunnyvale, Calif.

Since you're from Silicon Valley, you probably know the answer to your question: The survival game stinks. And nowhere does it stink more than in the technology sector. In fact, sticking it out in a low-growth technology business is a fast road to commodity hell, where you will be forced to endure a painful eternity of low-cost slugfests with offshore manufacturers. What a way not to go.

Clearly, you would be better off to find a new business where you and your team can grow and flourish. It appears your company has a business model, so survival, at least for the foreseeable future, is an option. That's good news. It means your immediate challenge will be harvesting the living daylights out of what you have to keep the cash flow coming. Meanwhile, you can figure out the new game, allocating the resources to acquire a business or start one from scratch.

Now none of this may seem particularly easy or pleasant—exiting a business rarely is. But you can take solace in the fact that your situation is entirely common. The environment starts to change under your feet, and suddenly your business doesn't make that much sense anymore. It happens every day all over the world, not just at startups. In fact, it's particularly common at established companies where new competitive dynamics emerge almost out of nowhere to upend the status quo. All too often in big corporations, unfortunately, certain businesses have become such shrines that managers do not react with the kind of clear-eyed realism that your letter suggests.

> Listen to Drucker: If you weren't in the business you're in, would you enter it today?

Look, change requires leaders to overcome all sorts of human dynamics, like inertia, tradition, and head-in-the-sand hoping that things will get better. But strategic moments require courage, or at least a lack of sentimentality, which is rare. It is in these moments that the best leaders find a mirror and ask themselves the defining question that the late, great Peter Drucker posed nearly 40 years ago: "If you weren't already in your business, would you enter it today?" If answer was no, Drucker said, you need to face a secon question: "What are you going to do about it?" Every should heed his advice and, if need be, follow it throug conclusion—whether it is to fix, sell, or close the busin

Congratulations for having done that already. Your decision may be tough in the short run but will ultima release your people from a losing work environment a them a chance to find a future filled with opportunity, even with your new venture.

I run a small shop—just five employees. Lately, I've been thinking about sharing my financials with the team, hopi they'll see why we need to be efficient every hour of ever and minimize absenteeism. I'm also hoping that "exposi numbers could build teamwork and foster innovation. W your advice?

–Bob Winyard, Cherry

Surely you know the old saying: "No good deed goes unpunished." Well, you might find yourself living it ver

That's not to disparage transparency. In general, the information you share with employees about costs and competitive challenges, the better. As you suggest, wh people know what they're up against, they feel a great of ownership and urgency. And the sense that "we're a this together" can jumpstart teamwork and innovatio sparking improvements in processes and productivity.

But there are real perils in opening the books, the ma being that it's hard to open them just a little bit. To mak of costs, you also need to expose revenues and profits. S you sure you're comfortable with the team knowing ho the business makes? They will, naturally, compare that with what they make, and eventually they will be able t extrapolate how much of the pie you have—and they dc

That gap may very well be something you're willing even proud to explain. If so, then there's probably no downside to sharing financial details. But remember t employees, no matter what size the company, have a p in their heads that estimates what they and every co-w worth based on performance. If you get the sense you information spree will scramble those notions, then t a less perilous way to get your people to care about th as much as you do. ■

Jack and Suzy Welch look forward to answering your questic about business, company, or career challenges. Please e-mail them at **thewelchway@businessweek.com.** *For their we podcast, go to www.businessweek.com/search/podcasting.ht*

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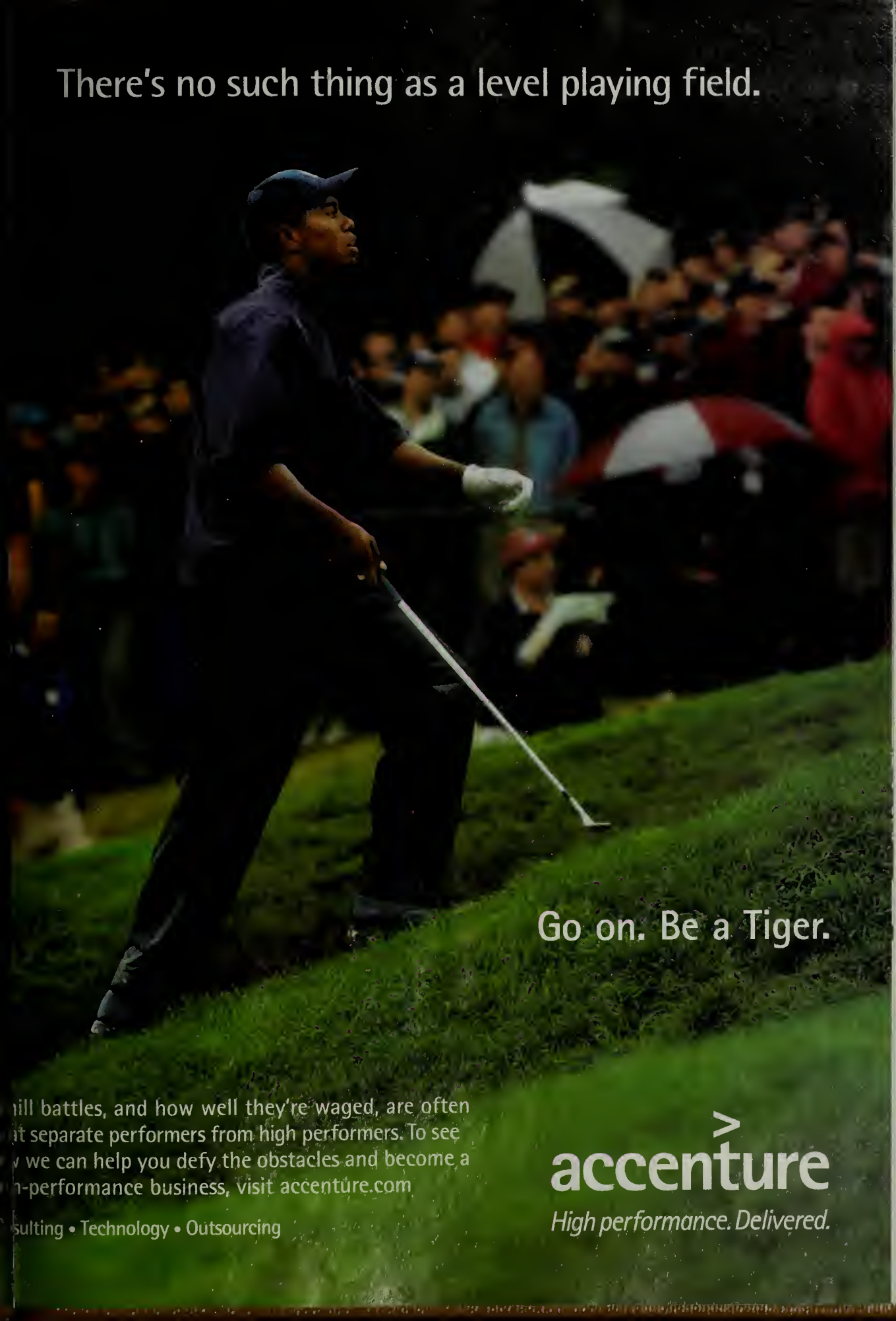
High-performance supply chain, delivered.

When the world's number one computer company set out to upgrade its already world-class manufacturing infrastructure several years ago, they began with a bold, yet simple premise: "build more systems with less inventory." In about 100 days, Accenture and Dell conceived and implemented an approach that allows Dell to operate on no more than two hours of inventory at a time. Now in place in Dell's plants around the world, the program paid for itself five times over during the first 12 months of operation. Dell is able to adapt more quickly to rapidly changing technologies and maintain its position as a high-performance business.

Office of Revenue Commissioners, Republic of Ireland

High-performance customer service, delivered.

To demonstrate how the public sector can improve customer service by embracing new technology, the Office of Revenue Commissioners, Republic of Ireland, wanted to introduce an electronic filing, payment and information system. Accenture developed and launched Revenue Online Service (ROS), a website that substantially simplifies the filing and payment process and provides online access to account information. The system uses digital certificates to give electronic tax returns full legal status. Introduced in September 2000, ROS has processed in excess of 6 million transactions and has brought in more than €21 billion in payments. ROS is now widely accepted by the Irish business community, and has allowed the Revenue Commissioners to establish a level of customer service and processing efficiency worthy of a high-performance government agency.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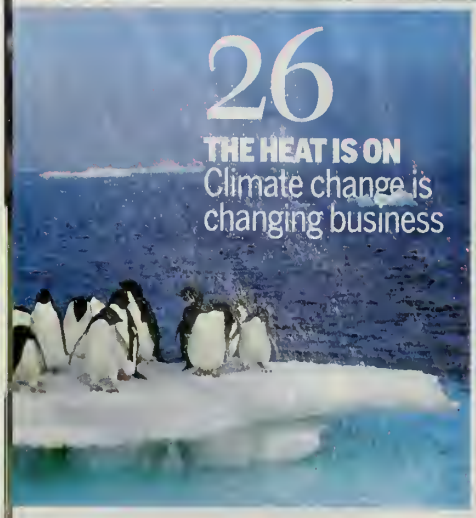

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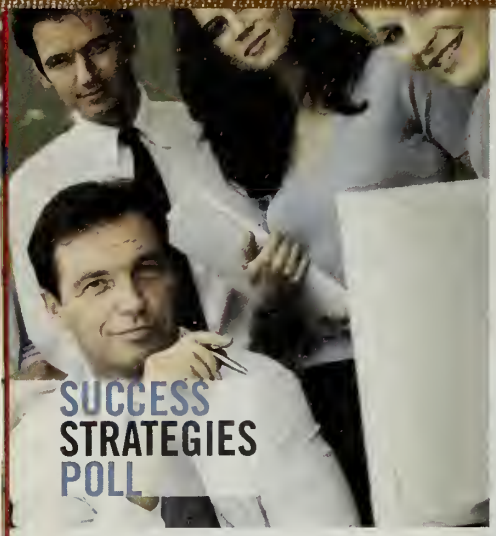

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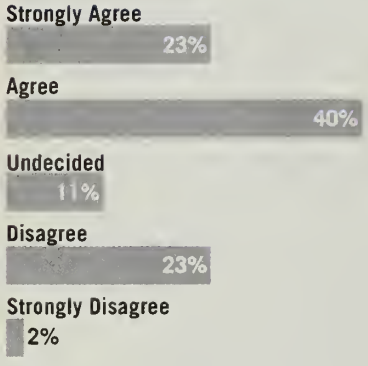

Results as of 6/29/06.

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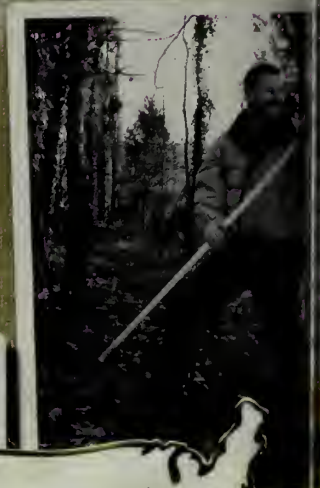

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UP Front

"Apparently, his heart simply gave out."

–Pastor Steve Wende of First United Methodist Church of Houston, on the death of former Enron Chairman and CEO Ken Lay

D BY DEBORAH STEAD

OR PAINS

IDING THE AMSTERS ESSAGE

UNREST may be g at **United Parcel** over the way drivers' n funds have long been ed. A group of UPS s in North Carolina has l a splinter union, the **ation of Workers of a,** to protest ucture of ension which co- s UPS utions on of its with those of other g companies. r the past decade, some e companies have elly-up, and the rebel rivers say this means e effectively subsidizing the pensions of drivers at these defunct companies. "I want the UPS workers to have a union and pension made up of UPS workers," says Van Skillman, a driver from Charlotte who is leading the APWA.

Through a spokeswoman, the Teamsters described the APWA as a "small, disgruntled group of workers" and said its internal polls show strong driver support for the Teamsters. It will be tough for the APWA to unseat the union, which has had a longtime presence at UPS. But Skillman insists that if a vote were held today among UPS drivers, "I guarantee we'd carry 18, and maybe 21" of the 25 states in the Northeast and Southeast his group has targeted for membership recruitment. *–Dean Foust*

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NALS OF PUBLIC RELATIONS

an e-mailed press release sent by Dave Overton ston-based Newman Communications:

ct: Why the demise of Ken Lay?

ne of the top reasons why CEOs get fired is "Denying Reality." ne could argue in Lay's case that the truth he would be forced nfront (bankrupt company, displaced workers, destroyed eggs, prison, etc.) was so horrible, and so unavoidable, that ody simply shut down rather than confront a terrible reality. y's death may be the equivalent of a child sticking their rs in their ears to avoid hearing something bad. But a lot e final.

lark Murphy is CEO of Leadership IQ, a Washington, D.C. d management consulting firm. Mark has some interesting ghts on the demise of Ken Lay and how others can avoid his Please let me know if you would like to speak with him. ks for your time.

OFFSHORE INVESTMENTS A rig in the Gulf of Mexico, where East Cameron Gas has operations

ISLAMIC LAW

Returns Muslims Can Live With

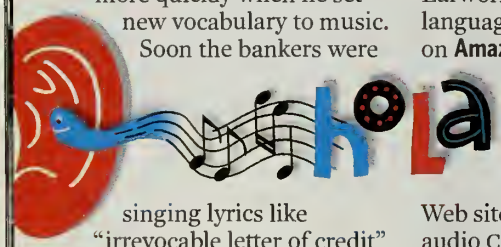
THE ISLAMIC PROHIBITION against earning interest has largely stopped companies from selling bonds into the $750 billion pool of capital managed according to *sharia*, or Islamic law. But investment bankers are finding a way around the ban. On July 5 bankers from **Merrill Lynch** in London and Beirut-based **Bemo Securitisation** were wrapping up a $166 million sale of debt-like certificates for a Houston natural gas producer, East Cameron Gas. The certificates, believed to be the first *sharia*-compliant securitized market financing of U.S. assets, are structured so that Islamic investors effectively get a fixed rate of return (11.25% annually) while considering themselves owners of the underlying assets. An official *sharia* adviser issued a *fatwa,* or declaration, certifying that the instrument "will yield returns, Allah willing, that are lawful and wholesome."

The investors may well need divine cooperation. The certificates are backed by only seven wells, two platforms (both damaged by last year's hurricanes), and some drilling rights 20 miles off the Louisiana coast. **S&P** preliminarily rated the certificates CCC+, a grade suggesting a 31% chance of default within two years. Still, the certificates attracted Islamic investors seeking alternatives to stocks. The deal, says Khalid Howladar, senior analyst for **Moody's Investors Service,** "is bringing this pool of liquidity to the attention of a lot of people." *–David Henry*

UP Front

BUSINESS SPEAK
NAME THAT EARWORM

WHILE TEACHING English to German employees of **HSBC** about six years ago, British linguist and musician Marlon Lodge discovered that his students caught on more quickly when he set new vocabulary to music. Soon the bankers were



singing lyrics like "irrevocable letter of credit" to Peter Gabriel's *The Story of OVO*. Now Lodge and his brother Andrew, a former oilman and also a musician, are selling CDs and MP3 downloads that offer language lessons using "earworms," musical phrases that stay stuck in the brain. **Earworms Publishing** issues audio lessons in six languages, including Mandarin, using a mix of jazz and pop composed by the Lodge brothers and others.

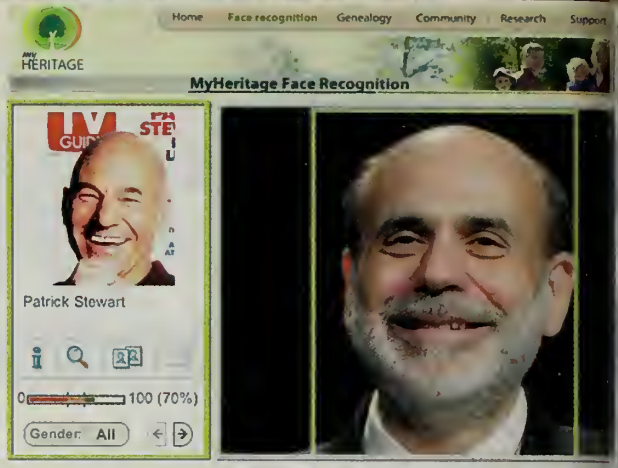
Soon after debuting on iTunes in January, Earworms' Rapid Spanish MP3s topped audiobook sales (ahead of *The Da Vinci Code*). And now Earworms has the top-selling language-learning product on **Amazon UK. Thomson Holidays,** a unit of global travel giant **TUI Group,** is selling the Rapid Language series through its Web site. And Earworms' audio CDs, available at British Borders shops, will soon be sold in U.S. branches. The series—soon to include Arabic and Japanese—will mix the professional with the pleasurable, says Andrew Lodge, so that students can "carry on a fluent, high-level business conversation or flirt effectively." *–Aili McConnon*

FED WATCH
ANXIETY OPTIONS

» **THOSE OBSESSED** with the Fed's next move will soon be able to trade (literally) on that preoccupation: On July 12 the Chicago Board of Trade will introduce an option that allows investors to gamble purely on the interest rates targeted by Ben Bernanke & Co. at their Open Market Committee meetings. (Existing federal-funds options are based on actual overnight loan rates, which fluctuate according to demand.)

Fed officials are likely to welcome the new instrument as feedback on how well the markets are translating Bernanke speak.

–Catherine Yang



SEPARATED AT BIRTH?

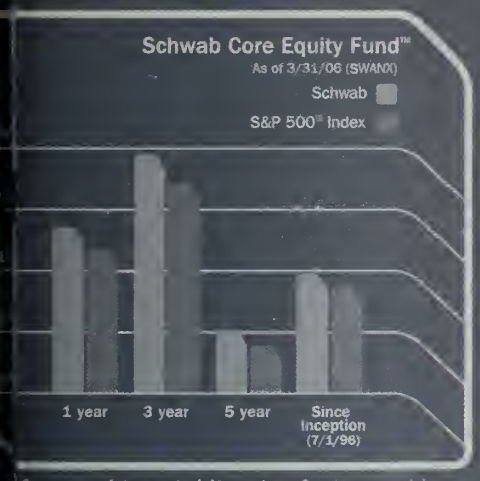
FACE-OFF What do Fed chief Ben Bernanke a actor Patrick Stewart have in common? A 70% similarity in facial structure, according to MyHeritage.com, a genealogy Web site. As it gears up for its beta launch this week, the site offers matchups between users (who submit photos) and celebrities, drawing from an imag bank of 3,200 famous people. Testing the site using pics of corporate types, *BusinessWeek* found the results far from convincing but relia amusing: Oracle's Larry Ellison was matched with Johnny Carson, Martha Stewart with par girl actress Tara Reid, and Google co-founder Larry Page with beautiful Bollywood star Madhuri Dixit. Donald Trump, fittingly, was a match with . . . Donald Trump. *–Elizabeth Wo*

DRAWN & QUARTERED

"MUMMY! DADDY'S NOT GOING TO GIVE AWAY MY *INHERITANCE* TO THE *GATES FOUNDATION*, *IS HE?!*

We thought about letting the S&P 500® win for a change.

(But then we thought, nah.)



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WEB WATCH

WHO SAYS E-ROMANCE IS DEAD?

Matchmaking sites may be putting some heat back into online dating, as they try to revive a maturing industry. Revenue growth cooled to an estimated 7% last year, according to Web analyst Jupiter Research, after hitting a peak of 77% in 2003, with subscriptions stuck at 5 million. Now the numbers look better. First-quarter revenues were up 35% from a year earlier at Match.com, while eHarmony anticipates "significant" growth in 2006. Yahoo also expects gains for its Yahoo! Personals. All three raised basic monthly fees by 20%, starting last year, targeting those willing to pay more: people seeking serious relationships. (For an added $8.99 over its $30 fee, Match.com subscribers can also get personalized advice, from Dr. Phil.) Meanwhile, nonpaying users, once able to send notes to prospective dates, typically have had such e-mail privileges revoked.

The industry "has caught its second wind," says Jupiter's Nate Elliott. But permanent gains, he warns, depend on attracting new subscribers, "and you can't do that by raising prices."

–Smitha Ballal

ON THE L TSF's O Walton a quake survivor Java

DISASTER RELIEF

Telecom's Geek Squad To the Rescue

ASKED TO NAME a team of specialists known for swooping into disaster zones to deliver relief, many of us could come up with Doctors Without Borders. But Telecoms Without Borders?

Known by its French name, **Télécoms Sans Frontières,** this little-known communications SWAT team is often among the first to arrive after a catastrophe—with laptops, routers, and satellite gear. TSF's 50 workers (15 salaried, 35 volunteer) have become a dependable geek squad for the international disaster-relief community. "Uninterrupted Internet communications are a lifeline for us," says Rajan Gengaje, a U.N. adviser who worked with TSF in the wake of the May 27 earthquake on the Indonesian island of Java.

Founded in 1998, TSF traces its roots to a homegrown volunteer network, Solidarité Pyrénée, started 15 years ago by friends who grew up near Pau, France, where TSF is based today. Two of the founders, Jean-François Casenave, now 51, and Monique Lanne-Petit, now 40, say that the idea for a telecom rescue group first took shape on an early mission. In Iraq during the 1991 Gulf War, Casenave says, many refugees "gave us a piece of paper from inside their shoes with a phone number and asked us to call their families."

Thus was TSF born. Today it has a $950,000 budget, funding provided by organizations like London satellite company **Inmarsat, Vodafone Group Foundation,** and, recently, the **U.N. Foundation.** Because 24-h mobilization is a TSF hallmark, volunteers mu live near one of TSF's th offices (Pau, Bangkok, a Managua). The group h 60 missions under its toolbelt, including the 2 earthquake in Iran, the tsunami in Southeast As and the 2005 famine in Niger. After the recent Indonesian quake, a TSF team, headed by Oisin Walton, 26, set up a comprehensive Internet and phone center for 11(rescue workers in the ci Yogyakarta.

TSF is now looking be emergencies. Staffer Ben Chabrier, 25, for instanc working in Niger, setting Web connections before year's famine season arri to ensure that help come quickly enough to do so good. "After four years o studying technology, technology, technology i school," he says, "I have found a social issue to pu computers to use."

–Catherine

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"Sit-downs with real teachers will result in a harvest of critical knowledge from behind the 'blackboard curtain.' "

–Mary Moree Paynter
Gainesville, Fla.

Readers continue to respond to our June 26 Cover Story, "Bill Gates gets schooled." A collection of letters and online postings ran in last week's magazine ("Grading the Gateses," Feedback, July 10). More reader comments are posted online (businessweek.com/magazine/content/06_26/b3990001.htm).

WHAT ELSE BILL AND MELINDA NEED TO KNOW

IF I COULD INFLUENCE Bill and Melinda Gates's initiative, I would encourage them to include more mentors for students in conjunction with a buddy system ("Bill Gates gets schooled," Cover Story, June 26). Twenty-five years ago, I was an out-of-wedlock child bouncing from one house to another, and my grades reflected the chaos in my life. I was surrounded by alcohol, drugs, and extenuating circumstances. Today, I interact with highly educated professionals. To move from then to now was an extremely difficult road.

I valued education, so I worked full-time during the day and went to community college at night, then juggled jobs and struggled with payments to graduate from the Rochester Institute of Technology. Instead of battling with decisions on my own, it would have been pricele me to talk to a well-intentioned, educ and experienced adult, and debrief v peer or small group.

–Camala A. Li
Falmouth,

EDUCATION PROFESSORS and p school supervisors and executives a removed from the front lines. Bil Melinda Gates should gather grou recently retired teachers from eleme middle, and high schools from sever eas of the country and harvest their dreds of years of experience and wis So many facts are never menti among them I.Q. and cultural differe

Teachers of young children know girls usually progress faster than bo the language arts. Boys are more rea age 7, when their hand muscles are l developed to write. If boys start too they feel failure at the beginning. F doesn't start their children reading the third grade, and in the sixth grad are tested to be the best readers i world.

Middle school teachers will tel that when the hormones are raging and girls would do better in sam

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ReadersReport

schools. High school teachers say that we are rushing our students too much. They have hardly enough time to go to the bathroom and eat lunch. We also need more physical education to expend that super childhood energy.

Sit-downs with real teachers will result in a harvest of critical knowledge from behind the "blackboard curtain."

–Mary Moree Paynter
Gainesville, Fla.

WHY THE AIRLINES WON'T BE CUTTING THOSE SAFETY DEMOS

"SATISFACTION not guaranteed" (News: Analysis & Commentary, June 19) does an excellent job demonstrating how extreme cost cutting can kill a business. But the article incorrectly implies that the flight attendants are a "nod to service" not yet removed by the airlines. In fact, flight attendants are required by Federal Aviation Administration regulation to ensure passenger safety. It's not a stretch to imagine that, if given the option, some airlines would cut the number of flight attendants on board or even fly their aircraft with only one pilot to save money.

–Benjamin M. Zeloof
Bridgewater, N.J.

HORMONE DRUGS: WEIGHING THE ISSUES

AS A MENOPAUSAL WOMAN, I read with interest "Homegrown hormone therapy: How safe?" (News: Analysis & Commentary, June 26). As I see it, the problem is not between the drug companies and the compounding pharmacies, which in actuality represent competing therapies dueling for the same market—one government sanctioned, one not—but rather that we are labeling menopause a disease and not just accepting it as a normal life transition.

As your article noted, the results of the 2002 Women's Health Initiative Study pointed to the risks in taking even Food & Drug Administration-approved therapies. For one month of my roughly 10-year perimenopause, I used a low-dose estrogen patch and Prometrium. The former made me bloated; the latter gave me the weepies. Now, happily and healthfully ensconced at 51 in full menopause, I am doing it the old-fashioned way—diet, exercise, and no pharmaceutical intervention. I embrace and celebrate this life passage rather than medicalizing it, which makes my voice, and others like mine, a dangerous third alternative to the two sides of the debate referenced above. They can both experiment on someone else.

–Karen Ann DeLuca
Alexandria, Va.

MANY WOMEN, myself included, have a need for hormone therapy and cannot take the synthetic drugs. The side effects, for me, were severe and quite intolerable. What is desperately needed is well-funded, unbiased research into the bio-identical hormones, not only to establish safety, but also standards of purity and manufacturing, so that consumers can make informed decisions regarding them. The compounding pharmacies are not the problem here. Indeed, they are the only viable option for the many people for whom conventional drugs present a problem.

–Hazel D. Burns
Lopez Island, Wash.

AS THE MONEY has shifted from Wyeth Corp.'s products to the bio-identical products, Wyeth has launched a campaign to solve their problem using political means to snuff their competition. Let Wyeth compete by making bio-identicals themselves. They can probably do it better. The only problem is that they can't have a monopoly on it because they can't patent them.

–John Grosberbg
Scottsdale, Ariz.

Editor's note: The writer is a patient using bio-identical hormones.

GINGER CONSTANTINE, Wyeth Pharmaceuticals vice-president for women's health care, may throw up her hands in disgust over bio-identical drugs, but many women are rejecting Premarin because of sympathy for the horses. Female horses are tied up for six months during pregnancy to collect their urine. The foals are sold for slaughter, since there are so many.

There are other chemically based estrogen drugs available. When women know how Premarin is collected, they opt for other estrogen drugs.

–Marilyn Sweet
Boulder, Colo.

WHY THE "PITIFUL" SAVINGS RATE DESERVES A CLOSER LOOK

"WHY THE SLOWDOWN won't become a slump" (Business Outlook, June 26) uses Federal Reserve data to state that the ratio of household net worth to aftertax income is higher than it has been in 5½ years. The ratio of liquid assets to income, at 67%, is the highest in 13 years. Using aggregate wealth data to justify the "wealth effect" on consumer spending is misleading. Studies show that wealth and net worth data are extremely skewed toward higher-net-worth households. It's estimated that the wealthiest 10% of households own about 80% of financial net worth, and the remaining 90% of households own only 20%. Moreover, high-net-worth high-income households have a l marginal propensity to consume tha vast majority of households. The latt spending their entire income and ex ing equity from their homes to buy more. The pitiful personal saving should be taken seriously.

–Edward M. Syn
Gulf Strean

Editor's note: The writer was an e mist with the Federal Reserve Ba New York and chief economist at M Midland Bank and E. F. Hutton & C

A LOVELY VINTAGE, WITH HINTS OF ETHANOL

I COULDN'T HELP BUT notice you quisite sense of time and space in pl your article on vino-augmented gas ("A hint of oak and berries at the pu UpFront, June 26) just preceding welcoming announcement of wine Robert Parker ("Welcome, Robert er," Editor's Memo).

I wonder if Mr. Parker has any ir as to whether a Bordeaux really doe vide more pickup than a rosé?

–Bill A
Buckingha

CORRECTIONS & CLARIFICATION

The table accompanying "This buyout g ain't over yet" (Finance, June 26) incorr noted that the Texas Rangers won two National League West titles. The Ranger won two American League West titles.

In "Trying to sharpen Jaguar's claws" (Executive Life, July 10), the Jaguar XK's aluminum chassis is derived from the Jaguar XJ. It shares only an engine bloc with the Aston Martin V8 Vantage.

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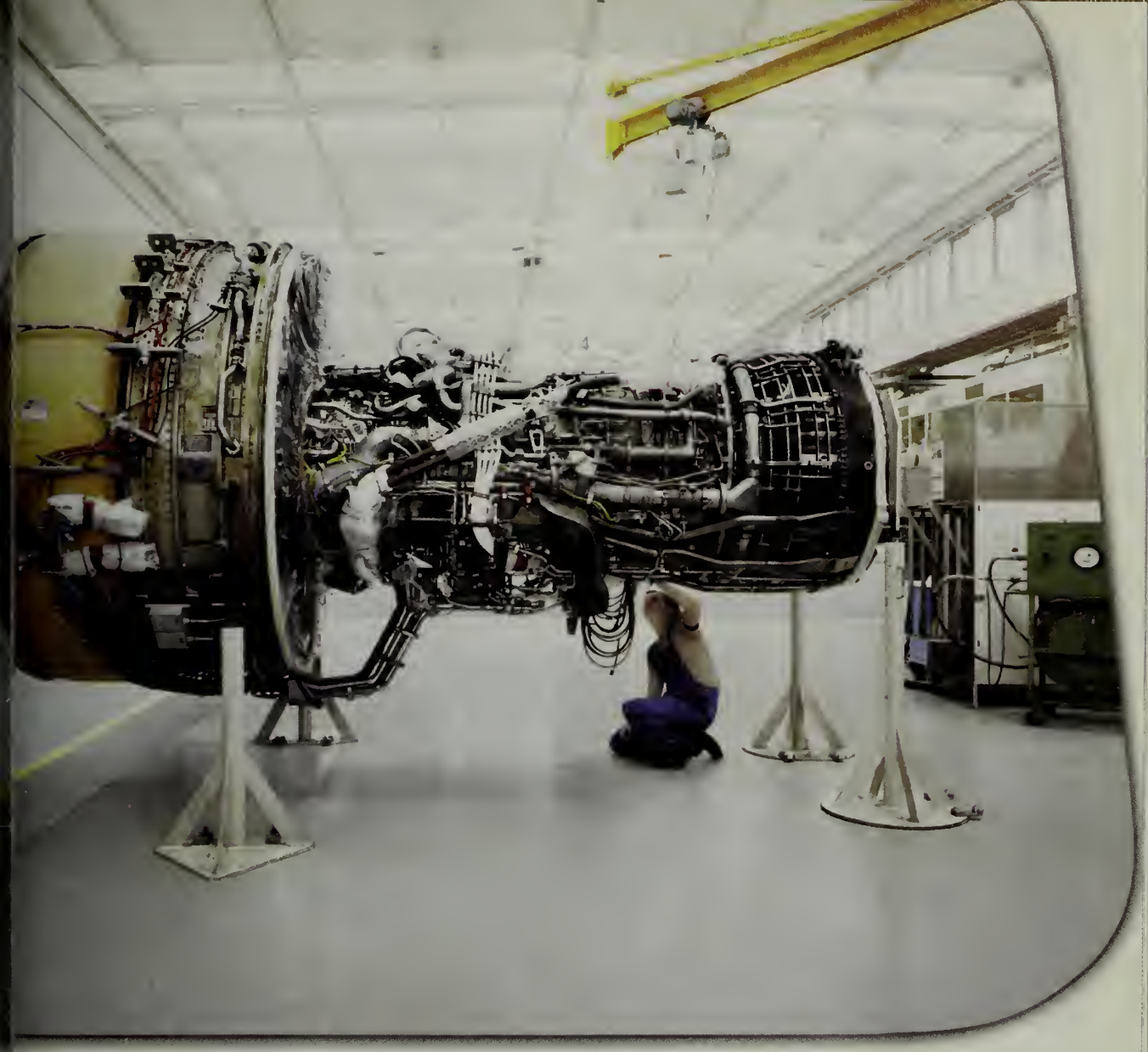

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Technology&You

BY STEPHEN H. WILDSTROM

The War for the Net's Future

Like most policy debates, the Washington argument over "network neutrality" is thoroughly uninformative. Both the cable and telephone companies on one side and big Internet companies like Google and Microsoft on the other claim to be protecting consumers. But there's a danger we users could get trampled in this fight among elephants.

The problem is that everyone wants to get into the business of on-demand video—phone companies, cable companies, and players such as Microsoft, Google, and Yahoo! Each group wants the playing field tilted to its advantage. Internet companies, backed by various public interest groups, claim the phone and cable companies want to turn the information superhighway into a private toll road. Rules are needed, they say, to keep the networks "neutral"—to prevent the network operators from discriminating against content created by companies that don't own the data highways. They especially want to prohibit carriers from charging extra for premium services such as video. Cable and phone companies, on the other hand, claim their opponents want to smother the Internet in regulations and get a free ride for their own advanced services.

Fortunately, there's a middle ground: We must acknowledge that public networks for everyone can exist alongside premium, private ones, and that these two types of networks can live by different rules. The Center for Democracy & Technology (www.cdt.org), a think tank on tech issues, argues for an approach that preserves the open nature of today's Internet while creating space for premium networks. This solution truly serves the interests of consumers and most businesses.

THE GLORY OF THE INTERNET is its openness to innovation. As long as you conform to some basic technical requirements, you can send any sort of data and create any service you want. E-mail, streaming video, online commerce, and the World Wide Web itself were all started by groups, companies, or individuals who did not need permission from regulators or network owners. The action took place on the very same lines that carry telephone and cable-TV traffic. But unlike those services, Internet activities were never subject to stifling regulations, which is why innovation was able to flourish.

This unprecedented freedom could be threatened as network operators consolidate, putting ownership of the Internet backbone into the hands of just a few corporations. New laws are needed to keep the Internet from degenerating into a closed and uninspired copy the phone networks. Specifically, network operators should be prohibited from blocking service such as Internet phone calls.

But even as we preserve compa freedom to innovate on the famili public Internet, we must make su innovation can thrive on new, hig speed private networks, too. That happen if Google, Microsoft, and others succeed in efforts to bar network operators from selling premium services. I would like to

Innovation must be able to thrive on both public and private networks

AT&T and Verizon Communi cations deliver high-quality v something today's Internet c do well. Google, Microsoft, Y and even YouTube would be to do it, too—and it seems fa them to pay a premium price premium delivery. Regulatio these networks should be minimal. Interestingly, cable companies provide a model: of their networks is dedicate the public anything-goes Int The rest is used for controlled delivery of video content.

CDT's formula for network neutrality calls for "basic n requiring network operators to preserve nondiscriminati and openness, but only on those portions of broadband networks dedicated to the [public] Internet." This isn't a simple as it sounds, and the devil will be in the details. Bu the best compromise I have seen. Congress' record of get right on tech issues is poor, but we can hope that this tim they will find a middle ground that can serve everyone. ■

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MediaCentric BY JON FINE

Media, Marketing, and Advertising in the 21st Century

Today Search, Tomorrow Ads?

Traditional media is so uncool these days that even Google feels bad abo it. ¶ Advertisers "overcorrected against the Internet" circa 2000 when th slashed online spending, says Tim Armstrong, Google's vice-president f advertising. "We see the same thing happening now with offline media.' Google is trying to rectify this. The company that takes in $6 billion fron

cryptic online text ads is still testing efforts to sell Old Media ads.

The way this works is Google purchases space at a discount from newspapers and magazines and then resells portions of that space to the hundreds of thousands of advertisers that buy the search engine's online ads. Its first stabs at this, to put it as gently as possible, did not set the world ablaze. In late May a top Google executive said the company's initial bids to place ads in magazines were among the company's biggest disappointments this year. Previously, *BusinessWeek*'s Ben Elgin reported that such efforts may have netted far smaller profits than the company is used to, if there even were profits. But Google is nonetheless readying another foray into ad placement in newspapers, perhaps this summer, with more papers this time than its first attempt. (Initially, such ads only appeared in the *Chicago Sun-Times*.) Another bid to crack the magazine ad code will follow. Later this year it will integrate its recently purchased radio ad-buying unit, dMarc, into AdWords, its pioneering Web ad auction system.

Since print still struggles with slow growth, it's interesting that not all executives welcome a potential source of new ad dollars. "I'd do business with them again. But I have no illusions about what they are trying to do vis-à-vis my business, which is take it over," says a senior magazine executive who has worked with Google. "They want to be the central clearinghouse for advertising for everyone."

The potential side effect this executive fears is that Google eventually undercuts magazines' existing relationships with advertisers by offering them cut-rate deals. Whether this fear is realistic or ridiculous, it nevertheless echoes how established media often views tech-driven newcomers. If this becomes Google's universe, what happens to the rest of us?

"GOOGLE HAS A near-religious belief that its digital [ad] bidding platform will be used for all media," says Jordan Rohan, a managing director and Internet analyst at RBC Capital Markets. But "outside of search, their batting percentage is pathetic." Like another behemoth, the one called Wal-Mart, Google cloaks ambitions to mediate substantial chunk of the economy beneath rhetoric about obsessively focusing on the customer, or, in Goo favored techie parlance, the "end us And Armstrong, unsurprisingly, is c to downplay Google's ad ambitions i traditional media. "This is not a zer sum game," he says. "We would lov be one of the winners."

Google's ad pitch is aimed at the in the audience, because it's all abou data. The click-through patterns on Google's familiar online text allow advertisers more or le real-time means to monitor effectiveness—better messag get more clicks—and thus various messages can be flu into the marketplace to find which works best. (Google-i note that offline ad message be tested online and then m into other media.)

Media folk fear Google will choke off their existing deals with advertisers

The idea is for this to be transposed into Google's pla Old Media ads, although no requires manually entering reams of data about where, w and what kind of print ad ran in what kind of publicatio Non-geeks may find this all eyeball-glazing, but at a time when every company expenditure is scrutinized ferociou pitch like Google's finds a ready audience. The big questi whether the ad world can give up its beloved ways of soft science—the easy currency of relationships and massive expense accounts—for a new world of hard data and ultr accountability. If it can, there's one big player with an aw lot of data on its hands. ■

BusinessWeek online For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia

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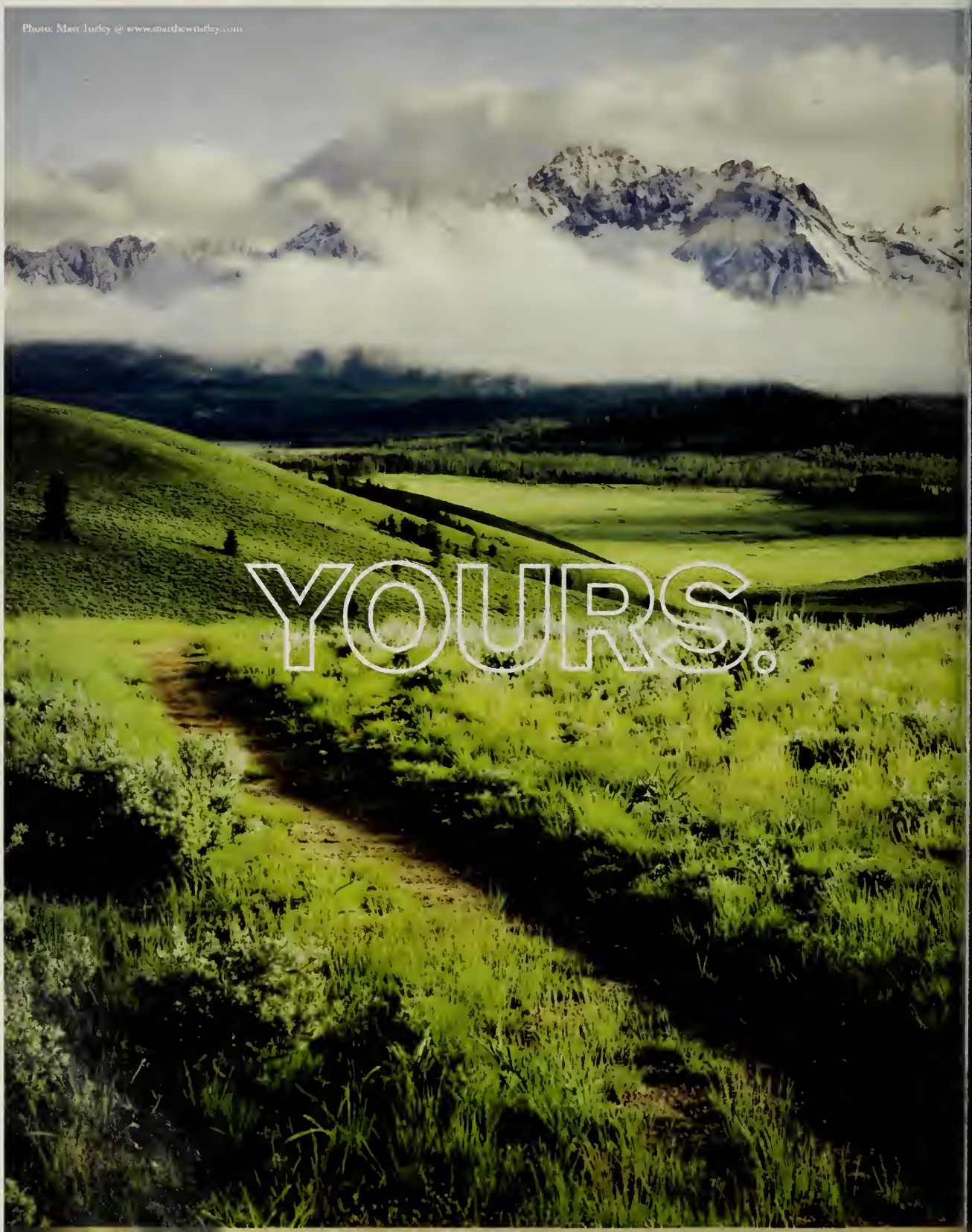

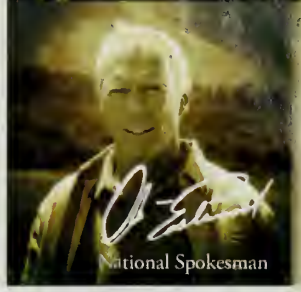

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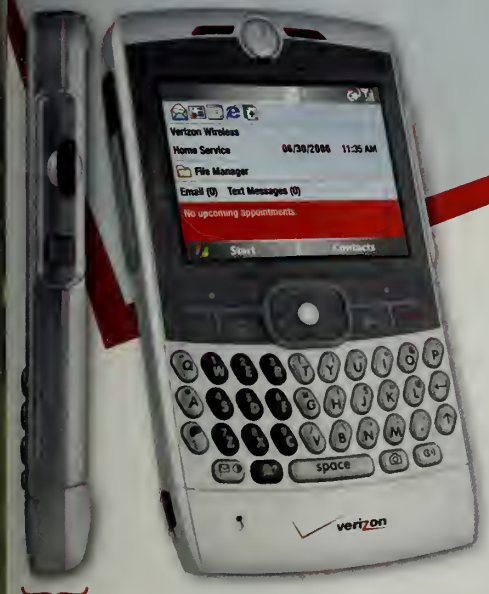

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AMES C. COOPER

Wall Street's New Mantra: In the Fed We Trust

slower growth and cooler inflation are still no sure bet

U.S. ECONOMY The Federal Reserve took a leap of faith at its latest cy meeting—faith in its economic forecast, that is—and both the k and bond markets leaped with it. The statement following the tral bank's June 29 hike in its target rate, to 5.25%, for the first e suggested the Fed believes demand is slowing in a way that entually take pressure off inflation. Such a scenario suggest, in turn, one more rate hike at most, and d would finally be out of Wall Street's hair. The ts zoomed on that prospect, but now comes the big on: Does the Fed have it right?

/be, but don't bet the ranch just yet. Growth in the l quarter is clearly cooling down from the first r's red-hot pace, which the government has now l up, for the second time, to a sizzling 5.6% annual onsumers and housing are leading the second- r slowdown. Most housing indicators are running their first-quarter levels, and consumer spending djusting for inflation barely rose in both April and hart).

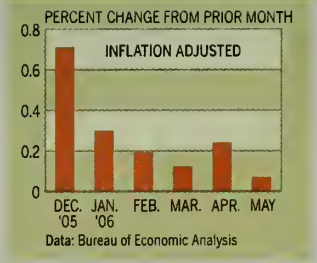
se two sectors will continue to strain under the t of higher interest rates and gasoline prices in the l half, but the depth and breadth of any slowdown broader economy isn't clear. Economic reports at d of the quarter, especially those from the labor ts, look a little firmer than earlier ones. Plus, tors of overall financial conditions, from the credit ts to bank lending to international finance, still pportive of demand.

h the likelihood of a lasting cooldown still not , the policymakers have put themselves in a tricky on with the markets. That's because the trend in on tends to lag behind that of economic growth. For ce, inflation outside of energy is picking up now in art because of past strength in overall demand and onetary policy. So if the economy is indeed slowing, take a while longer for inflation to ease.

KEY ISSUE AT STAKE resulting from this lag is how rkets view the Fed's credibility as an inflation . By backing away from the need to raise rates nflation readings remain elevated, the Fed could be s being dovish on inflation. This perception could expectations of higher inflation, which would begin force the recent uptick in the price indexes. Indeed, market measures of expected inflation rose a bit he Fed's statement.

most interesting feature of the June 29 hike was iking contrast between the hawkish comments of various Fed officials prior to the meeting and the decided lack of such hawkishness in the official statement. Its wording suggests that the Fed would like to pause, perhaps for fear of overtightening policy and hurting the economy. So the Fed's earlier strong anti-inflation rhetoric, coming as it did in the face of ugly-looking April and May price indexes, appears to have been less of a signal of future policy and more reflective of efforts to assure the markets of a commitment to fighting inflation.

THE SLOWDOWN IN CONSUMER SPENDING



Data: Bureau of Economic Analysis

Against this backdrop, July 19 should be a very interesting day. That's when Fed Chairman Ben S. Bernanke treks up Capitol Hill to deliver the Fed's semiannual Monetary Policy Report to the Senate Banking Committee. The chairman will also lay out the Fed's forecast for growth and inflation. If the June 29 statement is any guide, the Fed's projections are not apt to deviate much from its February outlook, which showed growth slowing from 2006 to 2007 by just enough to allow inflation to edge lower next year.

A new round of Bernanke's Fedspeak is reason enough to expect a volatile day in the markets. But this time the June report on the consumer price index comes out the same day as his testimony. That's a potentially explosive mix, especially if the inflation data look bad.

BERNANKE COULD END UP in the position of defending the Fed's sanguine forecast in the face of contrary inflation reports that argue for more rate hikes. A senator might logically ask: "Well, Mr. Chairman, if you expect growth to moderate and inflation to ease, why even consider another rate hike?" Despite the recent downbeat price indexes, inflation hardly looks out of control. The Fed's preferred measure of core inflation, which excludes energy and food, rose a moderate 0.2% from April. The 12-month rate has fluctuated in the

narrow band of 1% to 2.5% for the past decade. As of May, the 12-month rate is 2.1%. So far this year, the comparable five-month annual rate is 2.6%.

Wall Street sees this dilemma as one in which the Fed must prove its credentials as an inflation fighter by taking action with interest rates, not with words. While it's absurd to question the Fed's inflation-fighting resolve, it's not out of line to question its forecast, especially at a time when policy based on those projections could lead to a mistake that could cost the economy dearly later on.

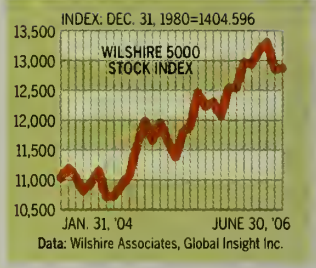
The Fed's June 29 statement left plenty of wiggle room for policymakers to react to future data on the economy. But if the central bankers' forecast is on the mark, the upcoming numbers on economic growth will be much more important than the readings on inflation. Since a slower economy is the *sine qua non* for slower inflation, signs that growth is moderating will be crucial to giving the Fed the credibility it needs to stop lifting rates.

THE PROBLEM IS, THE BIGGER RISK right now is that the data will not cooperate. Despite the economy's slowing in the second quarter, it remains uncertain that a cooler pace will prevail in the second half. Fewer jobless claims in June and a report of strong June job growth by ADP Employer Services suggest robust labor markets. June car sales edged up a bit from May, and Detroit is readying a new round of generous sales incentives.

Perhaps the most important reason to question whether the economy will gear down enough to send the Fed to the sidelines is that financial conditions, while less liberal than a year ago, remain far from restrictive. T true both in the U.S. and globally. Central bank polic rates, adjusted for inflation, in the euro zone are well below those in the U.S., and they are negative in Japa

For U.S. households, mortgage rates have moved up more than a percentage point over the past year, to 6.9 a 30-year fixed mortg but that's hardly pain for most borrowers. A while stock prices hav been volatile this yea broad Wilshire 5000 index, a good proxy f stock portion of hous net worth, is still abo ahead of a year ago a more than 15% ahead two years ago.

STOCK PRICES: STILL IN A FAVORABLE TREND



Data: Wilshire Associates, Global Insight Inc.

For corporations, credit markets remai receptive to borrowers, and surveys show banks also remain eager to lend. Finally, the dollar is still 17% b where it was in early 2002, and foreigners remain wi to use their stronger currencies to finance dollar-base investments.

With inflation ticking up, look for Fed officials to continue to speak forcefully and carry a big stick. And long as the policymakers' forecast for slower growth remains unproven, the stock and bond markets will be vulnerable to a sharp reversal from their June 29 rallie

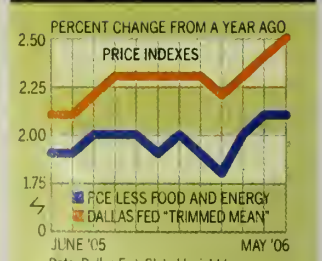
INFLATION

Two Reasons to Be Uneasy

THE LATEST LOOK at inflation by the Bureau of Economic Analysis showed May prices, excluding food and energy, were up 2.1% from the year before. While this core measure is the popular way to gauge underlying price pressures, most consumers feel inflation is higher. Indeed, alternative measures by regional Federal Reserve banks back up those perceptions.

According to the Federal Reserve Bank of Dallas' inflation gauge, called a trimmed-mean index, prices rose by 2.5% in May, the largest yearly gain since December, 2001. This measure uses the monthly personal consumption expenditure (PCE) price data. But instead of stripping out food and energy, the components with the biggest gains or declines for the month are excluded, leaving behind about half the components.

PRICE PRESSURES: BROAD AND STRONG



Data: Dallas Fed, Global Insight Inc.

While food and energy can be volatile, standard core inflation measures don't adjust for large one-time jumps or drops in other categories. Such sharp moves can "prevent you from getting a clear signal of the trend in inflation," says James Dolmas, senior economist at the Dallas Fed. So the Dallas Fed's May measure excluded an unusual 1% fall in men's and boys' clothing.

Another gauge, the Federal Reserve Bank of Cleveland's "median" consumer price index posted a 3% gain in May vs. the 2.4% yearly pace in the Bureau of Labor Statistics' core consumer p index. The Cleveland Fed ranks th CPI constituents in ascending ord then uses the monthly change of t middle, or median, category.

Both measures provide a bette way than the CPI or PCE to asses breadth of price pressures in the economy. The number of compo in the PCE price index that have posted monthly gains of 0.4% or more has gone from nearly 14% i December to 33% in May. This broadening shows up better in th alternative inflation measures.

Investors believe the Fed's Jun policy statement indicated a grea chance that interest rates will no hiked in August. These alternati inflation measures suggest, howe that price pressures may be even stronger than the mainstream indexes imply.

–By James Mehring in New

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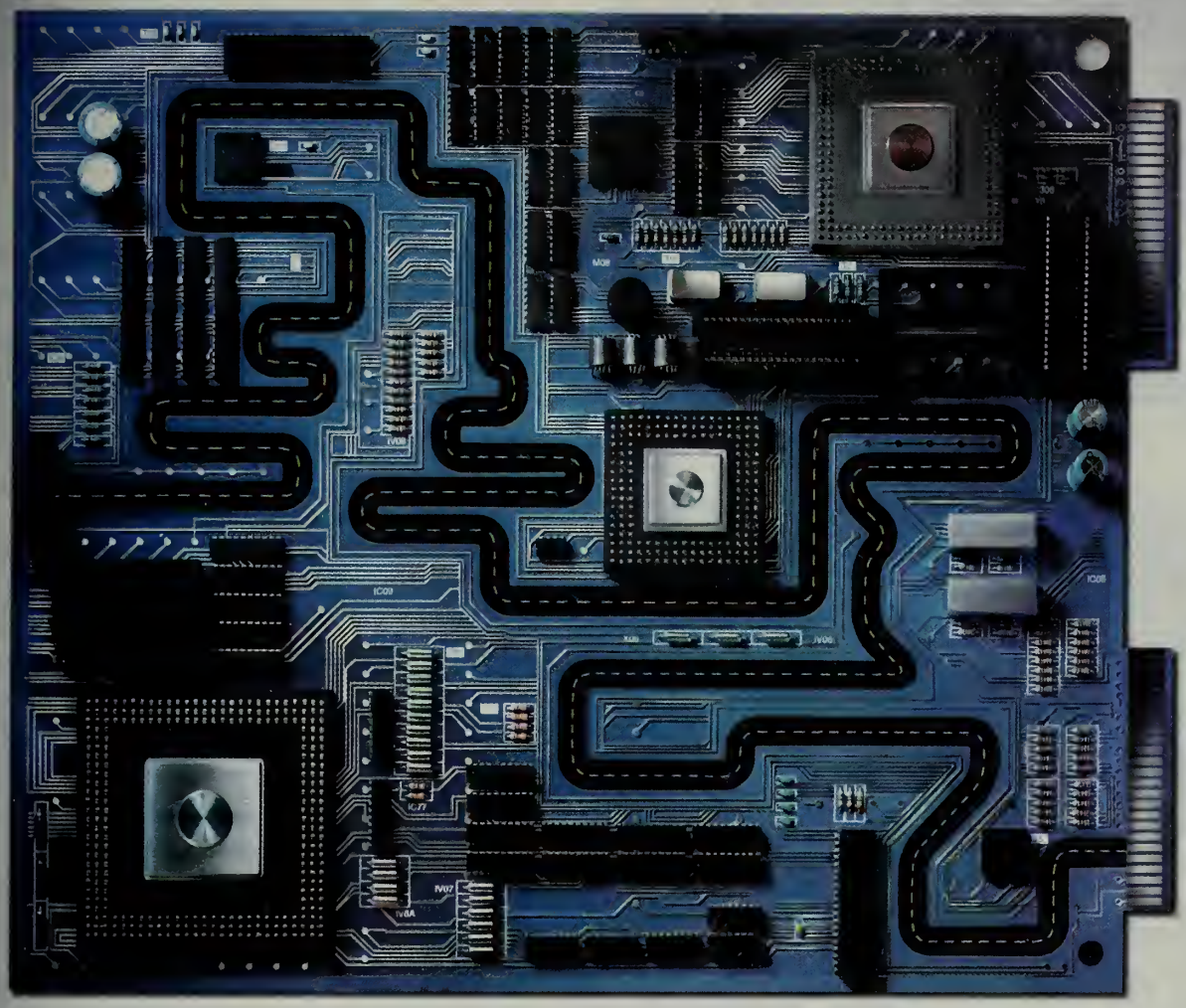

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The Business Week

News you need to know

EDITED BY HARRY MAURER

A Partner for GM? Just as **Detroit** was set for some quiet time around July 4—when car factories shut down for two weeks—billionaire **Kirk Kerkorian** launched a cannonade of fireworks. He said on June 30 that he wants GM (in which he is a 10% shareholder) to hook up with **Renault-Nissan.** Kerkorian would like Renault to take a 20% position in GM for about $3 billion. That would open the way for cost savings and shared technology.

But there is probably more in play here. Kerkorian deputy **Jerome York,** who sits on GM's board, has been critical of management and has praised Renault-Nissan **CEO Carlos Ghosn.** The subtext is that York wants Ghosn on GM's board, if not in the executive suite. Will it happen? GM executives whisper that they are cool to the idea, and shareholders of both Renault and Nissan have advised caution.

See "No silver bullet," page 29, and
ONLINE *"Can Nissan's Ghosn change GM's route?"*
www.businessweek.com/go/tbw

Shakeup in Airbus' Cockpit Shares of **European Aeronautics Defence & Space** went into a nosedive after Airbus revealed delays on the **A380.** Now, two top executives have been ejected. Airbus **CEO Gustav Humbert** resigned on July 2 along with **Noël Forgeard,** the EADS co-chief executive who was Airbus' boss from 1998 until last year. **Louis Gallois,** head of the French national railway, will take Forgeard's job, while **Christian Streiff,** a former executive of building-materials group **Saint-Gobain,** replaces Humbert.

ONLINE *See "'Major screwup' at Airbus,"*
www.businessweek.com/go/tbw

Twist of Fate **Kenneth Lay,** who transformed **Enron** fr small-time natural gas outfit into a dazzling star bef imploded in one of the greatest corporate scandals died at age 64 on July 5, apparently of a heart attac and former Enron **CEO Jeffrey Skilling** had been convict conspiracy and fraud on May 25 and were awaiting tencing. Lay might well have spent the rest of his li prison, though he had vowed to appeal. Various civil against him may proceed against his estate.

ONLINE *See "Ken Lay's dark, ironic leg*
www.businessweek.com/g

Whoopee! Higher Rates! Just for a change of pac **Fed's** widely expected 25-basis-point rate hike, to 5.25 June 29 sent the Dow on a 217-point romp. What gives ter weeks of anxiety stoked by confusion over Fed Chie **Bernanke's** remarks, the markets loved the central b accompanying statement, which highlighted sl growth. Alas, the relief didn't last long, as investors' e tations for yet another boost in August started edging

See "Wall Street's new mantra: In the Fed we trust," pag
ONLINE *and "Bernanke's timely bu*
www.businessweek.com/g

Mexico's Cliffhanger Has Mexico bucked the tren ward leftist leaders in Latin America? The July 2 vot the top two candidates within 1% of each other and expected to produce a winner by July 8, but legal lenges could prevent a formal declaration for weeks. U ficial results had center-right, pro-business candidat **lipe Calderón,** of **President Vicente Fox's** ruling **National A Party,** slightly ahead of leftist **Andrés Manuel López Obr** who pledged to raise welfare payments to reduce the poor divide. López Obrador alleged voting "irregulari and authorities are bracing for protests.

ONLINE *See "Mexico's election: Too close to*
www.businessweek.com/g

***Et Tu,* Apple?** On June 29, Apple became the gli name yet ensnared in the stock options accounting dal. The company said it had named two board mem and hired an outside counsel to look into certain op grants between 1997 and 2001. These include a ma grant to **CEO Steve Jobs** that was negated in 2003 wh was given restricted shares instead. The disclosure si that the scandal has yet to reach its apex, as tech bi continue the hunt for potential problems.

Travelport's New Home Back in April leisure an estate conglomerate **Cendant** said it might send its t business packing. On June 30 it found a destination: uitous private-equity giant **Blackstone Group,** which wi $4.3 billion for Travelport, a unit that includes **Orbit Cheaptickets.com.** Cendant originally had said it w breathe life into its moribund stock via a four-way ta spin-off. Coldly comforting: It won't incur a fat tax b this deal because it overpaid for the companies that up Travelport.

a Mobile Drops a Call Yet another Chinese acqui- overseas has come a cropper. On July 3, Luxem--based **Millicom,** which has 11 million cell-phone sub- rs in developing countries, said it couldn't close a vith China Mobile. Last year, Chinese oil producer C was thwarted in a bid to buy U.S.-based **Unocal,** and nce maker **Haier** lost an auction for **Maytag.** Failure of 5.3 billion takeover sent Millicom shares plunging, least one group was happy: telco equipment outfits as Sweden's **Ericsson,** which might have lost Milli- business to Chinese rivals such as **Huawei.**

e Eyes in New Jersey How's this for a high- game? **Atlantic City** police ushered gamblers from slot machines on July 5 when a New Jersey budget se prevented state gambling inspectors from report- r work. The government shutdown forced the city's inos to close their gaming floors while lawmakers ed over a one-point hike in the sales tax demanded **ernor Jon Corzine.** City casinos reported $16 million a lost revenue, a figure that could grow to $22 million re as cancellations mount. The hardest hit: **Trump En- ment Resorts** and **Resorts International Hotel & Casino,** properties are concentrated in Atlantic City.

: Talks Languish No heroic rescues were in store world's poorest at a **World Trade Organization** meeting **eva.** Stymied by long-running disputes over farm lies and tariffs, trade ministers folded their tents and ome early on July 1. The **Doha Round,** aimed at alleviating poverty by bettering terms of trade for developing s, now appears ready to receive last rites, since it an end-of-July deadline for an accord on tariff cuts. Chief **Pascal Lamy** told *The Wall Street Journal:* "It's a but there is a sense that it remains doable."

Conviction of the Week

time prosecutors got their man. On June 29 a state in Montgomery, Ala., convicted former **HealthSouth Richard Scrushy** on six counts of bribery, conspiracy, fraud for his part in funneling $500,000 to former **ma Governor Donald Siegelman** in exchange for a seat state hospital regulatory board. Siegelman was also found guilty in the scheme. Scrushy says he'll appeal. The verdict came a year after a federal jury acquitted Scrushy of fraud charges related to his alleged mastermind role in a $2.7 billion accounting scandal at HealthSouth, the Birmingham (Ala.) rehabilitation hospital chain. Scrushy, a minister who often invokes God in court proceedings faces still more tribulation. Attorneys are preparing for trial in two civil lawsuits against him related to HealthSouth fraud, and a federal lawsuit brought by **EC** heads to court next April.

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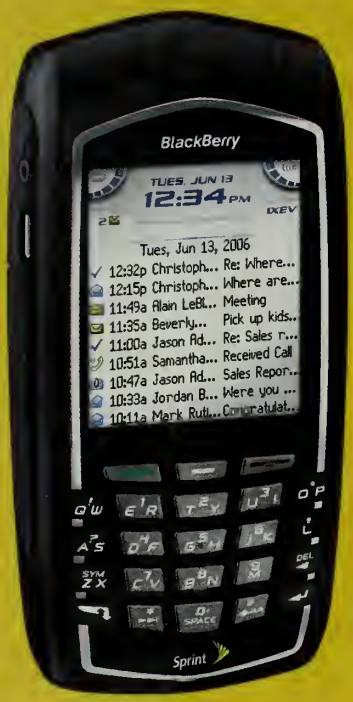

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CLIMATE CHANGE

BUSINESS ON A WARMER PLANET

Rising temperatures and later winters are already costing millions. How some companies are adapting to the new reality

BY JOHN CAREY

THE NORMAL BITTER cold of Canada's frozen north is tough on man and machine, but it's a boon for Diavik Diamond Mines Inc. Temperatures of -40F make it possible to build a winter "ice highway" over frozen rivers, lakes, and tundra. That's how the company usually hauls the thousands of tons of equipment, fuel, and supplies it needs for its mining operation 200 miles northeast of Yellowknife. "We freeze our butts off, but we use the climate to good effect," says Diavik's Tom Hoefer.

Not anymore. Winter temperatures this year were far above normal, so the road shut down early. Plus, the ice never got thick enough to support the weight of big trucks. Diavik was faced with a choice: Slow operations, or haul everything up by air. Because of the mine's value—it produces more than 8 million carats a year—top executives opted for the expensive airlift. Diavik had to find a Russian helicopter, one of the world's largest, to haul up a 500-ton hydraulic evacuator. Even then, workers had to cut their giant shovel into pieces for transport and weld it back together at the mine. Meanwhile, a Russian airplane has been flying around the clock, bringing hundreds of tons of clay needed for a protective dike, as well as other equipment. Diavik is spending millions of extra dollars "all because of the short ice road season," says President Mark Anderson. "I think a lot of people are becoming more convinced that climate change is real" and that we must adapt to it.

"INEVITABLE"

DIAVIK'S PREDICAMENT is just one example of a new inflection point in the story of global warming. Until now, the central quarrel has been over whether—and how best—to reduce the emissions of carbon dioxide and other gases that are responsible for climate change. Now it is clear to many that any curbs will be too little and too late to prevent significant warming. "No matter what we do now in terms of mitigation, changes in climate are inevitable," says Ivo Menzinger, head of sustainability and emerging risk management at insurance giant Swiss Re.

That means that companies, governments, and ordinary people may have to make expensive adjustments to cope with the predicted physical effects of climate change, which include rising sea levels, shifting agricultural cycles, and more severe storms. *Adapt or Bust*, warns the title of a new report from Lloyd's. "It will be huge. There will be so much we wil to adapt to," says Kristie L. Ebi, a sc at consultant Exponent Inc.

Change has begun. Rising tem tures are melting ice roads, forcir lages in Alaska to move, short growing seasons in Africa, and ca oil companies to change the way the in the Gulf of Mexico. "This is not an issue our kids will have to deal It's happening now," says Allan C an insect ecologist at the Pacific Fo Center in Victoria, B.C.

Several years ago, Carroll pre that warmer temperatures could f ecological switch, causing the loss o able forests of lodgepole pine t mountain pine beetle. Normally, the are held in check because newly ha bugs are killed by cold starting in la That forces the tiny beetles into a year life cycle and keeps them fro tacking trees at their most vuln time, in late summer. But when C charted rising temperatures in Briti lumbia, he realized that early, killin was a thing of the past. That, he wo would enable the beetle to switch one-year life cycle and spread like wi

His predictions came true. "This time when I'm unhappy to be right, roll says. Years of fire suppression

IN THIS SECTION:

A cash infusion can't begin to fix GM's woes **30** | Target's credit-card business: At risk? **32** | An iffy diabetes blockbuster for Pfizer **34** | Hedge funds are likely to get some new rules

SHISMAREF, ALASKA The town may be moved—at a cost of more than $100 million

created prime beetle habitat, large stands of same-age lodgepole pines. That has made it easier for the beetle, which has now wiped out 22 million acres of forest—an area the size of Maine—in British Columbia. Within six years, scientists expect, it will have killed 80% of the mature lodgepoles in the province and could be rampaging across Canada and the U.S. "No natural forces can stop the beetle until it kills all of its natural habitat," warns Hamish Kimmins, professor of forest ecology at the University of British Columbia. Right now, loggers and sawmills are running flat out to process the dead trees. But the boom won't last. "Ecologically it's not a disaster because the lodgepole pine will regenerate," says Kimmins. "But it's a social disaster because so many communities are dependent on logging and pines."

The scientists who study the pine beetle say it presents a cautionary tale. Other nasty surprises are expected to arise from the delicate dance of nature and climate, affecting both public health and the economics of entire regions. In China, for instance, the line below which there are no hard freezes has moved northward. Since freezing temperatures kill the snail that spreads the parasitic disease schistosomiasis, this change is putting 20.7 million additional people at risk for the illness. Field studies show that the snail can survive in the new areas, says Guojing Yang, an infectious disease expert at Jiangsu Institute of Parasitic Diseases in China. Meanwhile, in Alaska, a rise of 9F in the temperature of the Yukon River since 1985 has been linked to the spread of a salmon parasite. By the time the fish make it upriver, they're too diseased to be sold. That's wiping out upstream fisheries and contributing to an overall decline in commercial fishing, explains Richard M. Kocan, professor of fishery sciences at the University of Washington.

Sub-Saharan Africa is also confronting new burdens because of climate change. "Over the last several decades, temperatures are up two degrees in Mali, and the rainy season has decreased by more than a month," says Exponent's Ebi. That means the growing season is too short for standard rice. Researchers are developing a faster-maturing variety, but that's only a partial solution, health experts caution, since the dry season's potato crop is starting to fail as a result of increased heat. The economic system of the whole country could collapse, says Ebi. "In the village I'm working with, the elders know they are on the edge."

So are the residents of the village of Shismaref on the west coast of Alaska. With melting permafrost and the disappearance of sea ice that once protected the town from pounding waves, "Shismaref is literally being battered to the point of falling into the sea," explained Sheila Watt-Cloutier, chair of the Inuit Circumpolar Conference, in recent Senate testimony. The townspeople have voted to move the entire village, which will cost more than $100 million.

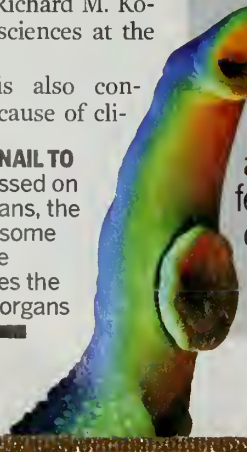
Adapting to a warming earth is an urgent issue in the Arctic, where a degree jump in average temperature the last 30 years is an example of "cli change on steroids," says Joel Sm vice-president at Stratus Consulting state of Alaska is setting up a blue-ri commission to identify risks and s gies for adaptation, but businesses a ready adjusting. The allowable peric traveling on the tundra has shrunk 220 days in 1970 to about 100 changing the way companies explo oil and gas. Cruise lines are are tryi cope with shrinking glaciers and va ing sea ice. While the governme thinking about policies to reduce cli change, "business is focusing on ad tion," says Robert Page, vice-preside sustainable development at Can power giant TransAlta Corp. in Ca "How do we adapt to a future of me permafrost, less water, and more ext weather?"

SEE NO EVIL

THE KEY, SAY PAGE and others, is r nizing that the future will not be lik past. Hurricanes Katrina and Rita, f ample, "toppled what companies ceived as a worst-case scenario," Cindy Gordon, refining-issues mana the American Petroleum Inst Drilling rigs were destroyed by storms, so the API has issued tou standards, such as anchoring platf more securely and requiring a ce height above the water. In San Fran planners are exploring beefing up storm sewer system to deal with he rains. And the European Environ Agency warns of coming drought water shortages. In the past year, a tion to the problem of adaptation

A World Tour of Trouble

Think the biggest challenge is cutting carbon emissions? If only. The costly effects of global warming are already being felt the world over. A few examples:



FROM SNAIL TO YOU Passed on to humans, the schistosome parasite damages the body's organs

- Ice roads are melting, so Canadian diamond miners mu airlift equipment at great cost instead of trucking it in
- More severe storms and rising seas mean oil companies must build stronger rigs, and cities must build higher seaw
- The loss of permafrost and protective sea ice may force villages like Alaska's Shismaref to relocate
- Yukon River salmon—and fisheries—are threatened by a surge in parasites associated with a jump in water tempera
- Later winters have let beetles spread in British Columbi killing 22 million acres of pine forests, an area the size of M
- In Mali, Africa, crops are threatened. The rainy season is too short for rice, and the dry season is too hot for potatoe
- In China, the habitat of a snail that spreads schistosomi has expanded, putting 20 million more people at risk

a quantum leap," says consultant , who has helped identify issues es like Denver and Aspen, Colo. ne climate skeptics argue that the is too uncertain to know what o take. One federal government ! says his Bush Administration ers won't allow any talk about cli- 'change." Instead, he can attrib- nusual weather patterns only to al climate variability." True, un- nty is a given. Forecasters can't tell year will bring more Katrinas or more heat waves like the 2003 blast in Europe that left thousands dead and nuclear power plants threatened with shutdowns for lack of cooling water. But when it comes to the big picture, the proverbial canary in the coal mine "is dead," says Peter H. Gleick, presi- f Pacific Institute for Studies in opment, Environment & Security land, Calif. "You can look at any n isolation and question it." But ned together, the only conclusion "we are faced with unavoidable, sible impacts," he says.

'too ny, issue ardly the ar een

most companies, the issue is on the radar screen. Forty sur- by Andrew J. Hoffman, professor ainable enterprise at the Univer- Michigan, say they are primarily ned about meeting possible ouse gas emissions curbs, not ad- to climate change. But they and are beginning to grasp the prob- of nasty weather surprises. That lf is "a positive development," urr Stewart, strategic planning ger for the Port of Seattle. Creating capable emergency management as Seattle is doing, "is another f adaptation," he says.

e environmentalists worry about adaptation. If people believe they pe with climate change, why to take action to reduce carbon ons? The answer, given new sci- suggesting more rapid climate e than expected, is that preventive would make the task easier. "This the beginning," warns Peter , head of Geo Risks Research at h Re. "As climate change is accel- , we will have to adapt to many extreme events."

CAR GUY Retiree costs come before any turnaround by Ghosn

DEALS

NO SILVER BULLET

Hold those cheers for Renault-Nissan-GM

BY DAVID HENRY

WHEN KIRK KERkorian proposed the sale of a stake in General Motors to Renault and Nissan on June 30, fellow GM investors cheered as though the troubled U.S. icon had a new lease on life, sending its stock up 8.5%. But before GM turns around, it will have to deal with a chronic and familiar problem that a tricontinental alliance can't fix: employee retirement benefits.

An investment by Renault and Nissan Motor Co., the French and Japanese companies that own stock in one another and are allied through a common chief executive, Carlos Ghosn, won't make a dent. Never mind GM's $30 billion in debt. It has an even bigger obligation that's not even on the balance sheet: post-employment health benefits, which amount to $42 billion, estimates Rod Lache, an analyst at Deutsche Bank. That's more than 12 times the $3.3 billion investment that Renault-Nissan would make if they were to buy even 20% of GM stock at its recent market value of $16.5 billion.

Let's say Renault-Nissan delivered all $3.3 billion in cash. So what? Last year, GM's car business burned $6.7 billion; next year, analysts estimate, it will hemorrhage as much as $4 billion.

CLAIM CRUSH

GM IS STILL the world's No. 1 automaker by market share. Yet it's worth only $16.5 billion, compared with $170 billion for No. 2 Toyota Motor Corp. That's indicative of just how many claims weigh on GM's assets. Besides the $42 billion in retiree obligations and $30 billion in debt, GM is on the hook to former subsidiary Delphi Corp. for $6 billion to $12 billion. (These figures exclude GMAC, its financing arm, most of which is being sold.) All claims considered, GM's stock accounts for a quarter of its so-called enterprise value, or theoretical takeover price. Enterprise value includes debt and other liabilities, less cash, that would be assumed by a buyer. It offers a sobering glimpse into the Renault-Nissan deal: Despite the 8.5% jump in GM stock, the market saw it adding only 2.1% to the value of the company.

Analysts say that if GM can shrink its production capacity and win relief from retiree obligations, there could be value in an alliance. Given a few years, cost savings, shared research, and brand consolidation could boost profits. Glenn L. Reynolds, debt and auto industry analyst at CreditSights Ltd., says Kerkorian's proposal could spur investors to focus not only on whether GM will survive but also on how it might best be part of the consolidation of the global auto industry.

It's a good point. GM used to be the one putting up the money in alliances. Now it's the one that's taking it. At this juncture, that's the turnaround worth celebrating.

RETAILERS

WHERE TARGET MAY MISS THE MARK

Its high-interest-rate credit-card business is looking riskier

BY ROBERT BERNER

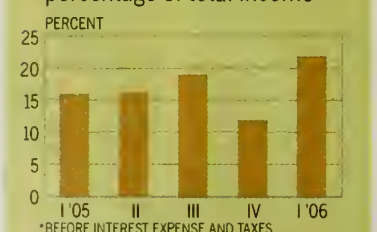
WHEN TARGET CORP. reported its first-quarter earnings in mid-May, analysts were annoyed that the retailer missed their consensus forecast by a penny per share. But few seemed to notice that three-quarters of the company's 15% earnings gain came from its credit-card operations, not its retail business.

They should be paying closer attention. Credit industry watchers say a rise in defaults is coming. Higher interest rates and energy costs will squeeze some consumers; others will be hurt by a weaker housing market, which makes it harder to tap home equity to pay bills. The result, say experts, will be rising delinquencies and defaults for credit-card lenders.

That could be bad news for Target, one of the few retailers that underwrites Visa cards and keeps some of the risk on its books. "If the consumer weakens, Target will be hurt," says Allen Puwalski, senior financial analyst at the Center for Financial Research & Analysis in Rockville, Md. "And it will be hurt disproportionately to other lenders."

SCARY NUMBERS

Credit-card income as a percentage of total income*



*BEFORE INTEREST EXPENSE AND TAXES

Data: Company reports

When the company added Target Visa to its regular department-store card in 2001, the idea was to attract high-credit-quality borrowers and expand the lending business. But only one of those things has happened. A close look at Target's $5.8 billion credit-card operation reveals a portfolio growing at four times the rate of other lenders and brimming with riskier borrowers—a dangerous combination.

Data culled from regulatory filings show clear signs of rising credit risk. For example: Target's increase in overdue accounts that have yet to be written off, taken as a percentage of total receivables. That's an indication that a rise in write-offs is coming, notes Puwalski, who used to do risk analysis at the Federal Deposit Insurance Corp. Comparing Target with eight finance companies that have similar portfolio characteristics, including GE Capital and Capital One Financial Corp., Puwalski found that Target had the biggest jump in delinquency rates, from 4% at the end of last year to 4.8% in April. Five of the other lenders declined or remained flat. Target's adoption this year of new rules that require higher monthly payments accounts for some of the rise.

Even more surprising is the yield—the combination of interest and fee income—that Target earns on its portfolio. Given that it is competing against other Visa issuers for customers, William Ryan, an analyst at New York investor research firm Portales Partners, says he would expect Target to have a relatively low yield, close to that of a mainstream lender such as Citibank, which clocks in at 17.4%. But Target's 27.2% is closer to the 31% of Metris, now part of HSBC Finance Corp. Metris is a so-called subprime lender that specializes in lending to the riskiest consumers. It charges such high rates be its borrowers are subprime; Target's yield suggests that it's attracting sub borrowers, too, says Ryan. Target cou that its yield is high in part because i not offer low teaser rates.

BOTTOM FISHING

BY ANOTHER BENCHMARK, Targ pears just as shaky. The three-month age of seriously delinquent accou those more than 60 days late- write-offs, amounts to 8.4% of Targe ceivables, Puwalski says. That's the se highest rate in the nation among le with securitized receivables over $1 b trailing only the 16% at Metris. "This the perception that Target's customer pristine credit," Puwalski says. Targe that it runs a "high-quality" credi portfolio, and that "the presumpti heightened risk...is unfounded."

Indeed, Target is expanding its po aggressively. In May its $5.8 billion ceivables was up 12% from the month a year ago, vs. 3% growth f industry as a whole. Much of the e sion is coming from accounts with balances and high credit limits, says Stango, an economics professor at mouth College's Tuck School of Bus who studies retail credit cards. March, 2002, to September, 2005 ances in excess of $5,000 made u fastest-growing portion of the portfol creasing from 9.5% to 28.6%, accordi

tory filings. The fastest growth in the umber of accounts came from those redit limits over $10,000, which tripled, to 3 million. Puwalski says ggests Target is raising credit limits existing customers to borrow more. question is: Did Target also lower lerwriting standards as it lifted bal- and credit limits? That's what hap- to Metris, whose rapid rise in high- e and high-limit accounts led to in 2002 and 2003. Target insists it lowered its standards. Even so, it ppy in 2004 to grant a Visa card to Austin, 48, of Superior, Wis., al- she had maxed out the $12,000 line on her Citibank card and was earning $17,000 annually at the YMCA. She took the 10% off, in-store incentive to buy patio furniture and got a $7,000 credit limit. "I didn't think I would qualify because I was maxed out on my Citi card," she says. When she hit the $7,000 limit a year later, Austin says, Target bumped her line to $10,000. When she hit that mark and Target raised her limit to $12,000, she turned to a credit counseling agency, which has negotiated lower payments with Citi and Target.

A shopper with a $17,000 salary got a $12,000 credit line

Some credit counseling agencies say that among the debts they see, balances on Target cards are growing fastest. At Lutheran Social Service of Minnesota, the number of new clients with Target Visas is has risen 8.7% this year, while the balances are up 12%. "You have to assume Target has relaxed its [underwriting] standards," says Lutheran Counseling Coordinator Daniel Williams.

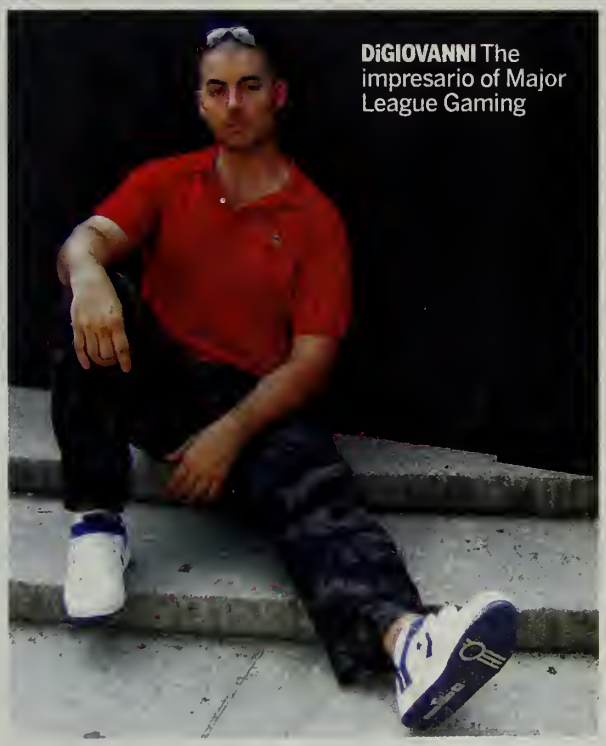
When Target's credit customers start to falter more dramatically, it stands to reason that its retail sales will suffer, too. Maybe by then more analysts will be paying attention.

EO GAMES

HE DUDE UBE

l a gaming league : boys back to TV?

NALD GROVER



DiGIOVANNI The impresario of Major League Gaming

BY THE SECOND DAY OF the tournament the playing field at the Anaheim Convention Center is littered with pizza boxes and crushed Red Bull cans. Fans in baggy pants and ill caps cluster around monitors for nd Nintendo consoles for Round 2 Boost Mobile Major League Gam- o Circuit event. Hip hop blares as ze flat-screen TVs catch superstars s and Daniel Ryan (a.k.a. The Ogre) blasting away *Halo 2* opponents. e candy for geeks. It's also prime r video gaming's P.T. Barnum, 33- ld Sundance DiGiovanni (his real no joke) who, with shaved head actor's good looks, works the Ana- rowd with an electric smile.

It may not be the National Football age, but video gaming is moving way d its origins in kids' basements to a ng presence on TV. In November, League Gaming (MLG) will begin tournaments on Saturday morn- n the USA Network, which can be 89 million U.S. homes. There's al- a four-year-old World Series of Gaming, founded by the William Morris Agency Inc., which will be shown on the Voom high-definition channel starting in September. And DirecTV Group Inc. will air three tourneys via satellite in August and then launch its own league in 2007 in partnership with Microsoft.

REBEL STREAK

WHO'S GOING TO WANT to tune in to watch a bunch of kids huddled over game consoles? TV executives say they aren't worried, insisting that this will be good TV, with split screens to show ongoing games as well as background vignettes similar to the spot portraits produced for Olympic athletes. "If we can make a hit out of guys racing around circles with NASCAR, we can do it with kids on their computers," says Steven Roberts, DirecTV Entertainment vice-president, who, in addition to Microsoft, has signed sponsors such as Best Buy and Mountain Dew.

What's more, airing video game play is a clever way to try luring back to TV one audience that has fled the small screen in droves for other entertainment options: teen boys. And DiGiovanni, who managed a video arcade in high school in upstate New York, may be just the guy to get kids to sit in front of the tube: He has enough of a rebel streak to endear him to 14-year-olds.

After a failed movie-directing career, DiGiovanni met former bond analyst Mike Sepso, and the two launched MLG three years back, raising $10 million in venture capital. Today they stage online competitions as well as seven tournaments a year, turning game play into Web content and cell-phone shorts.

While Sepso crafts MLG's direction, DiGiovanni markets the tour with the gusto of a Vince McMahon—the smashmouth impresario of pro wrestling. As a gaming commentator for ESPN2's Cold Pizza, DiGiovanni created a following among gamers that has helped him sign on hot players. "He's a cool dude," says 19-year pro-player Tom (TSquared) Taylor. "He told me to practice, and I did." Sounds like marching orders for a league of virtual warriors.

BIG PHARMA

FROM PFIZER, IRRATIONAL EXUBERA?

Its insulin inhaler may not be as big a diabetes blockbuster as expected

BY ARLENE WEINTRAUB

JANET RUHL MAY BE Pfizer Inc.'s worst nightmare. Ruhl, who injects a small amount of insulin each day to control her diabetes, has been dissing Pfizer's soon-to-debut diabetes remedy on her new blog and on a Web discussion group. The treatment, Exubera, is the first product that lets diabetics inhale insulin powder rather than inject the drug. But Ruhl, a 57-year-old software developer and author from Gill, Mass., says she thinks Exubera will be hard to use and could cause lung damage. "It looks like a terrible idea," Ruhl says.

RUHL She's worried about the drug's effects on lungs

Pfizer executives have told Wall Street analysts Exubera could ultimately bring in $2 billion a year in sales. But amid mounting resistance from patients and physicians, some analysts now wonder if it will be worth even half that much. "We feel they will fail to gain traction," says Sanford C. Bernstein & Co. analyst Richard T. Evans. Dr. Michael Berelowitz, a senior vice-president at Pfizer, responds that there is "quite a lot of pent-up interest" in the drug.

Pfizer could use a new blockbuster. In the month of June alone, its $12 billion cholesterol-buster Lipitor came under attack when a competing drug went generic; it pulled out of a partnership to develop a promising insomnia treatment; and its blockbuster antidepressant Zoloft lost its patent protection. With the loss of such gold mines, the pressure on Exubera only increases.

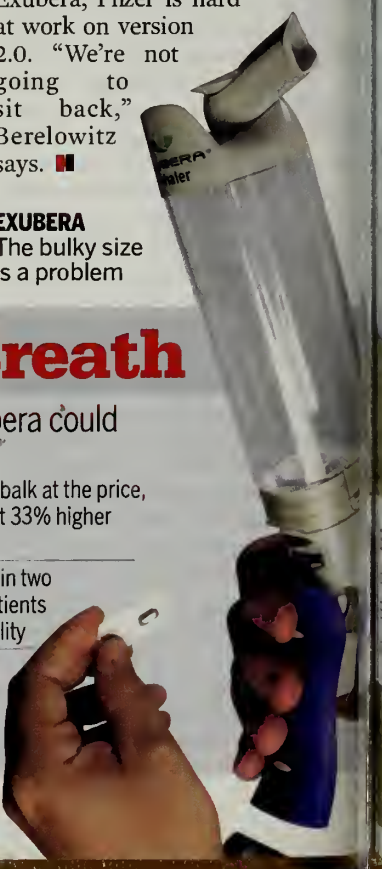
Exubera's big virtue was supposed to be that it's inhalable, but even that could prove to be a liability. Some patients in the clinical trials suffered lung problems. Pfizer recommends that physicians withhold the drug from patients who perform poorly on a lung-function test. Those who get the drug will need to have their lungs retested periodically. With such hassles, "there's not a lot of enthusiasm," says Dr. Joel Zonszein, director of the clinical diabetes program at Montefiore Medical Center in New York.

Pfizer's pricing plan could also be a turnoff. The list price of $122 to $140 a month is at least 33% higher than that of injected insulin, according to a June 22 report from Cowen & Co. That means most health insurers will charge their highest co-pays for the drug, and they could impose limits on who can get it, dooming prescribers to endless paperwork and phone calls.

Then there are the clumsy qualities of the inhaler. Exubera's insulin doses come in only two sizes, making it hard for patients to tweak their intake based on meal or exercise plan for the day, wan Richard A. Jackson, a senior physici the Boston-based Joslin Diabetes C Plus, when the device is unfolde about the size of a can of tennis balls. patients may be embarrassed to use public. Pfizer executives have been ta up Exubera as the pain-free alternati patients who are afraid of syringes. B runaway success of a new drug Byetta—which patients inject twi day—has sent the whole idea o needle-phobic patient right out the dow, physicians say.

Pfizer considers Exubera a revoluti new choice, and Berelowitz says the pany has launched "a hugely extensi ucation campaign" to train physician nurses how to incorporate the device complete diabetes care regimen. To lung-safety fears, the company launched a trial of 5,000 Exubera "We'll study them for as long as it tak ensure the drug is safe, Berelowitz sa

With Exubera doubts on the Pfizer is on the offensive. Its sales chine is gearing up to target diabetes cialists and general practitioners. has not revealed its advertising plan Bernstein's Evans estimates the com will spend more than $50 million a pitching Exubera directly to consu With competitors racing to de inhalers that are less clunky Exubera, Pfizer is hard at work on version 2.0. "We're not going to sit back," Berelowitz says.



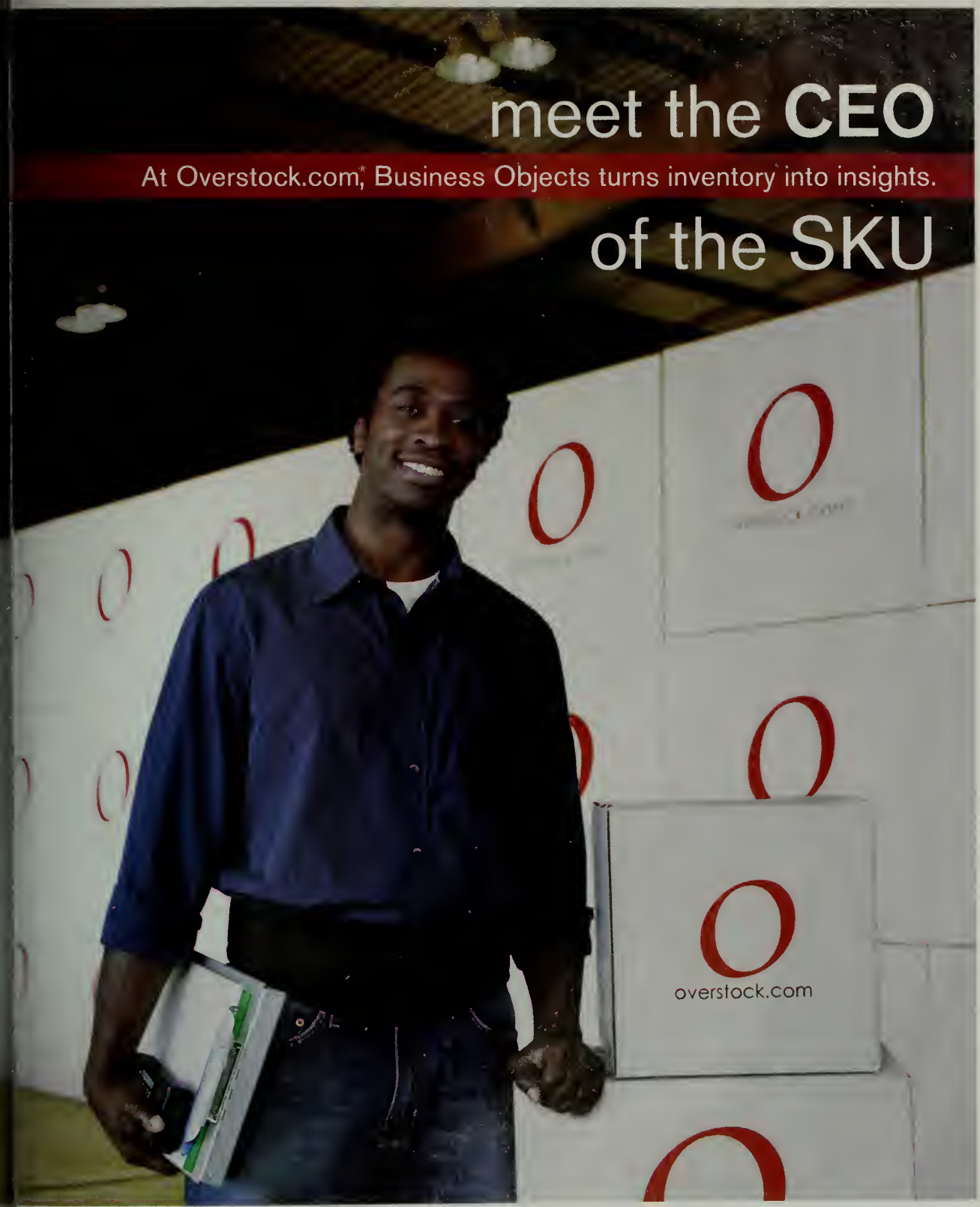
EXUBERA The bulky size is a problem

Deep Breath

Here's why Exubera could be a tough sell:

- Health insurers may balk at the price, estimated to be at least 33% higher than injected insulin
- Exubera only comes in two different doses, but patients often want more flexibility
- Some doctors are afraid the drug may harm patients' lungs over the long term

Data: Cowen Group, *BusinessWeek*



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OVERSIGHT

THE SEC ISN'T FINISHED WITH HEDGE FUNDS

It's closing in on shady practices despite a setback from a federal court

BY MARA DER HOVANESIAN

THE HEDGE FUND COPS may be down, but they're hardly out. In late June a federal court nixed the Securities & Exchange Commission's new hedge fund registration rule, which required funds to provide the SEC with basic information and subject themselves to random audits. The U.S. Court of Appeals for the District of Columbia Circuit called the rule "arbitrary" and, with a thump of the gavel, returned regulation to its pre-Feb. 1 state, when funds weren't required to open up the books for the SEC unless asked formally.

But don't throw a party for the hedgies just yet. During the nearly five months when registrations were taking place, SEC examiners found enough shady practices to keep investigators busy. "The SEC is still very much hot on the trail and will pursue the industry with whatever legal tools it already has," says Mitchell E. Nichter, a partner with Paul, Hastings, Janofsky & Walker in San Francisco.

The SEC is looking into a raft of abuses. Tops on the list: secret agreements, known as side letters, that give choice investors privileged information about holdings or special redemption terms. Funds are also under scrutiny for improperly valuing investments to hide losses or trump up returns to protect management fees. And SEC examiners say some funds are invested so heavily in exotic instruments that they couldn't come up with cash quickly if investors were to stampede for the exits.

Regulators are taking a hard look at side letters and evaluating whether disclosure alone will suffice. But legal experts say the SEC or Britain's Financial Services Authority will soon wipe out the practice. "We're going to see an expressed prohibition of side letters," says attorney James C. McCarroll of Reed Smith in New York.

Valuation is a hot topic, too. Many funds own thinly traded securities and complex derivatives whose values are subjective. The convergence of hedge funds and private-equity funds, which invest in private companies that aren't easy to value, makes matters more difficult. Says McCarroll: "Month-to-month valuations often are handled internally, creating potential for tension between a fund manager's drive to maximize perf ance-based fees and the need for hc conservative valuations." Christoph Kundro, managing director and cor ant at BearingPoint Inc., calls valu "a ticking time bomb."

Hedge fund losses can lead to pa larly unsavory valuation practices. S Ferris Wyderko, acting director o SEC's Investment Management Divi said in recent congressional testi that many past enforcement against hedge funds have involve "valuation of fund assets in order to losses or to artificially boost perf ance"—and that this has become part of the examination process i past few months. Funds, claiming ce investments are difficult to value, put 10% to 15% of their portfolios i called side pockets, sequestered fro overall package. But some of the qu tined assets are merely poor perforn

After shelling out what Chai Christopher Cox calls "significan sources" for policing hedge funds, it likely the SEC will turn down the now. Under f al antifraud the SEC is al investiga hedge funds in bankruptc es as well as access to in information.

At the time, the ma place is demanding higher standard effect, the SEC has achieved its objec says Don Putnam, a managing partn Boston's Grail Partners, an advisory chant banking firm. "There is de fact ulation; the industry is learning clients want safer hands." Micha Tannenbaum, a partner at Tannenl Helpern Syracuse & Hirschtritt in York, predicts a combination of self- ing and government intervention. " SEC gets knocked out, Congress picks And I think everyone would rather oversight by a bunch of politicians."

Every Move They Make

The SEC is determined to pursue industry abuses. Here's what it's looking for:

SIDE LETTERS
Secret letters to a few investors granting special privileges

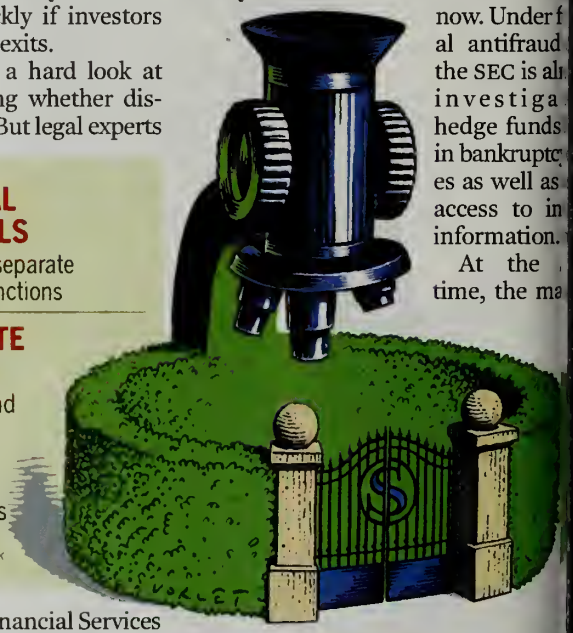
SIDE POCKETS
Accounts where poorly performing investments are concealed

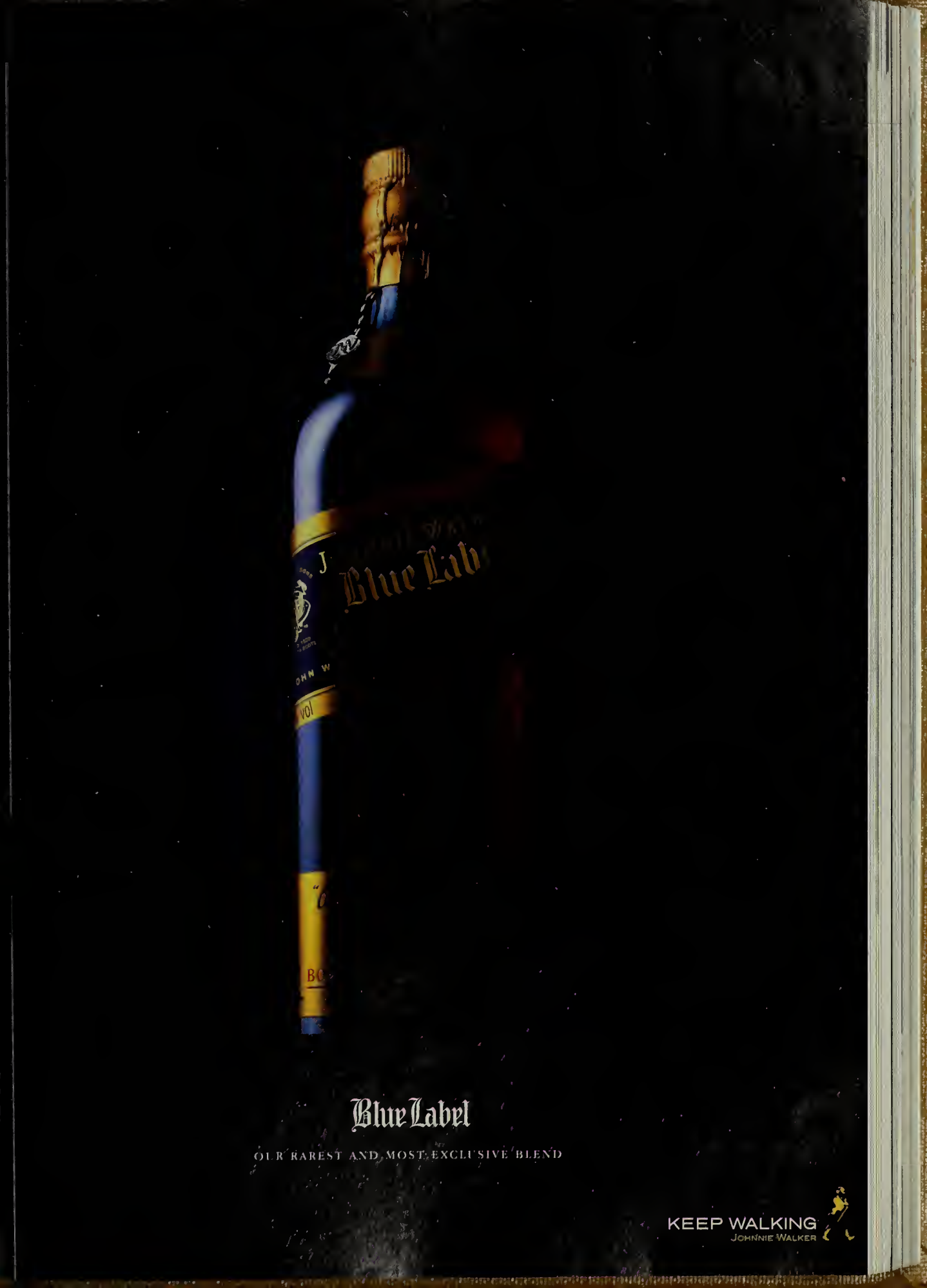
VALUATION GAMES
The lack of a consistent and reasonable system to price portfolios

INTERNAL CONTROLS
A failure to separate business functions

ADEQUATE CAPITAL
Cash on hand to fund sudden, substantial redemptions

Data: *BusinessWeek*




Blue Lab
Blue Label
OUR RAREST AND MOST EXCLUSIVE BLEND
KEEP WALKING
JOHNNIE WALKER

TOKYO GR
Toyota R
Garden in
sky scrap
district of

JAPAN

WAY, WAY OFF-ROAD

Toyota has moved into consulting, prefab houses, advertising, health-care support, even sweet potatoes

BY IAN ROWLEY

LOOKING FOR THE BIGGEST Toyota on the market? You'd do well to skip the Tundra pickups and Sequoia SUVs down at your local dealer. Instead, take a trip to the Toyota factory in Kasugai, a city of 300,000 about three hours west of Tokyo. There, the models on the assembly line don't amount to much in terms of acceleration or horsepower, but boy, are they ever roomy—as in multiple bedrooms, a living room, kitchen, bath, and patio.

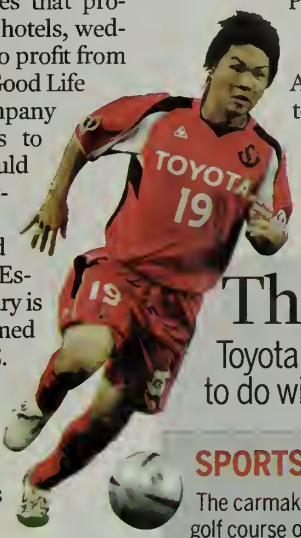
The Kasugai plant is one of three Toyota factories in Japan that make prefabricated houses. Just like Toyota's cars, these come with fancy, foreign-sounding names and plenty of options, such as solar roof panels and keyless entry. For those with a Corolla-size budget, the top-selling, 1,300-sq.-ft. Smart Stage runs about $175,000, excluding land. For the Camry set, there's the 1,800-square-foot Espacio Mezzo, with three bedrooms and a garage, selling for about $225,000, though add-ons can take buyers into Lexus territory: At least one big spender laid out $860,000 for a super-size version.

Even as Detroit's carmakers have virtually all of their noncore assets world's most successful car compa heading in the opposite direction. T controls dozens of businesses that virtually nothing to do with automa ranging in size from resort develope gasaki Sunset Marina (77% owned by ota), with just five employees, to Toyo nancial Services Corp., a wholly o subsidiary with 8,000 workers and billion in operating profits in fiscal All told, revenues for Toyota's nor businesses jumped 15.5%, to $10.3 bi in the year through March, and a

ince 2003. While last year's total still ented less than 6% of Toyota's over- es of $180 billion, if broken out the any's sideline businesses would rank 2 among companies in the Standard r's 500-stock index.

RLESS MANURE

ES ARE JUST the beginning. The au- er owns 100% of Delphys Inc., an tiser with revenues of $660 million. 's Toyota Amenity, a wholly owned liary with 69 employees that pro- consulting services for hotels, wed- alls, and restaurants. To profit from aying of Japan, there's Good Life n, a 51%-owned company offers support services to al institutions. And should ployees go hungry, Toy- uld turn to Toyota Bio esia, a grower and ssor of sweet potatoes. Es- ed in 2001, the subsidiary is wned by Toyota and aimed es of $860,000 in 2005. n there's Tokyo-based Roof Garden. As its suggests, the sub- —70% owned by —designs and sells ery for rooftops, using rom China to create paces high above the . Toyota expects the ss to grow as govern- across Japan promote planting on to combat rising temperatures in And on July 1 the unit began selling composting ingredient developed ontact lens maker Menicon Co. that, g other things, removes offensive from manure.



NAGOYA'S KEITA SUGIMOTO

at's the point? One clue can be in Toyota's history. The company l out making power looms for s textile industry. But Toyota er Kiichiro Toyoda, after dismantling and rebuilding engines on Chevrolets ported to Japan, quickly recognized tential for autos. In 1935 he built t car, the A1. Two years later, Toyota Corp. was spun off. Following that on of corporate exploration, since oyota has had a New Business Pro- mmittee to look into concepts in eas, including factory automation, onics, and biotechnology.

ge is another factor. Just as Toyota ed its Prius hybrid to build an eco- ly profile—while churning out ore big trucks and SUVs—invest- latively small sums in new tech- es can go a long way in the PR stakes. While few of its nonauto businesses are huge profit drivers, Toyota says the aim of such sidelines is to use its technology and intellectual assets to "enrich society."

Not all the investments are totally unrelated to autos. Some of those Indonesian sweet potatoes, for example, are used to make biodegradable plastics that have found their way into Toyota cars. Panasonic EV Energy, 60% Toyota-owned, develops batteries for hybrids. And like many other automakers, Toyota rakes in big bucks from financing its vehicles.

Still, Toyota says it can find synergies in many activities that have nothing to do with cars. At Kasugai, Toyota's houses are 85% completed at the plant before being transported by road and built in just six hours. To improve efficiency, the company borrows knowhow from its fabled Toyota Production System with its principles of just-in-time delivery and *kaizen*, or continuous improvement. Anticorrosive paint is applied evenly to houses' steel frames using methods adopted from car production. And just as in all Toyota's Japan auto factories, a banner proclaiming "good thinking, good products" hangs from the roof. "We follow the Toyota way in housing," says Senta Morioka, a managing officer at Toyota.

Where possible, Toyota also uses components developed for cars in its houses. One example is the keyless entry system which uses a radio sensor to lock or unlock the doors automatically. And to help keep out burglars, the windows are made of the shatter-resistant glass that Toyota uses in its windshields.

> Toyota's sideline businesses would rank No. 192 on the S&P 500

Yet for all that, many wonder what a car company like Toyota is doing in housing, roof gardens, and advertising. For the most part, analysts and investors turn a blind eye. One reason, of course, is that it's difficult to quibble with a company that posted earnings of $12.5 billion last year, enjoys operating margins near the top of the auto industry, and is poised to sweep past General Motors Corp. as the world's biggest carmaker in the next year or so. "There's a certain amount of complaining about this kind of stuff [from investors], but it's a rounding error when compared with their total spending," says Christopher Richter, an analyst at brokerage CLSA Asia-Pacific Markets in Tokyo.

Kurt Sanger, an analyst at Macquarie Securities, adds that Toyota's wide-ranging interests also mean it will have ample padding if the company's plans for global domination in autos fall short. "If things got really bad one day," he says, "they've got lots of things they could sell." Anyone want a used roof garden?

–With Hiroko Tashiro in Tokyo

The House Toyota Built

Toyota controls dozens of companies that have nothing to do with making cars

SPORTS

The carmaker holds 31% of golf course operator Toyota Mizunami Development and a 23% stake in the Nagoya Grampus Eight professional soccer team.

HOUSING

Toyota Home aims to build 5,000 prefabricated houses this year. A year ago, Toyota took a 13% stake in Misawa Homes, another maker of prefabs.

AEROSPACE

Toyota owns 97% of Aero Asahi, a helicopter operator and surveying outfit, and 75% of airport-management company AirFlite Japan.

GARDENING

The automaker holds 70% of Toyota Roof Garden, which puts greenery on rooftops, and owns half of ornamental plant seller Toyota Floritech.

CONSULTING

Wholly owned subsidiary Toyota Amenity provides management and consulting services to hotels, wedding halls, and restaurants.

ADVERTISING

Toyota is the sole owner of ad shop Delphys, which last year saw sales of $670 million on campaigns for Toyota, cellular carrier KDDI, and others.

Data: Toyota

CHINA

A KEY NEW ALLY IN THE CANCER WAR

China gets help from the West—and both gain

BY BRUCE EINHORN

AMERICANS AND EUROpeans may sometimes associate China with software piracy, huge trade imbalances, or censorship of the Net. But China and its Western trade partners are fighting together on at least one front: the war on cancer.

Consider the case of a 42-year-old civil servant who wishes to be known as "Ms. Li." She received a mammogram at General Military Hospital in Beijing in June, which was an unusual event given that the equipment is still scarce and the price for such tests is high. Lucky for Li, her office picked up the tab as part of a new government-backed program to test 1 million women in the next three years. Many of them, like Li, will be screened and treated using the most advanced technology the West has to offer. Li's doctors discovered an early-stage tumor, and they plan to treat it aggressively. "Cancer is curable," says Li. "People who make a face when they hear the word 'cancer' don't understand science."

Enlightened self-interest is driving Western medical companies and research institutes to join China's war on cancer. Naturally, they want to help upgrade patient care at a time when cancer rates are soaring. With pollution fouling the air and the tobacco industry booming, the lung cancer toll alone could triple within two decades from the current 340,000 per year. At the same time, the researchers want access to China's pool of talented scientists and its enormous patient population.

Researchers want access to China's pool of scientists and patients

Technology helps with the first part of the agenda, as the new breast cancer program demonstrates. Using an approach called digital mammography that is just starting to catch on in the U.S., doctors gather test results in a central database in Beijing, which is open to researchers around the country. Chinese are also experimenting with new forms of ultrasound screening. "They are moving at warp speed, relative to what would happen in the U.S.," says Dr. Stephen F. Sener, a surgeon at Evanston Northwestern Healthcare who advised the Chinese on the new program. "We would still be having committee meetings."

In exchange for helping the Chinese in such efforts, Western experts gain the freedom to work in China, where doctors and patients can help them test the latest drugs and procedures. AstraZeneca r cently announced plans to inve $100 million in China, much o going to cancer-related researc GlaxoSmithKline and Eli Li have launched cancer trials China. Yale University is licen ing technology for ovarian ca cer screening to SurExam Li Science & Technology in She zhen. And last month, Houstor MD Anderson Cancer Cent teamed up with a university ho pital in Tianjin, its fourth pa nership with a Chinese hospit Together, "we will answer que tions [about cancer] that we a incapable of answering in t U.S.," says John R. Seffrin, CE of the American Cancer Socie which is working closely wi Chinese oncologists.

1 MILLION MAMMOGRAMS Test are government-subsidized

EASY TRIAL RECRUITMENT

CHINA'S VAST patient popul tion is a big draw for clinical o cologists around the world. F one thing, researchers ca study forms of the disease th are rare in the U.S. or Europ says Dr. Zhang Shangwen, professor at the Beijing Medic University School of Oncolog What's more, some drugs m work best on Asian patients. D Tony Mok, a professor of clinic oncology at the Chinese Unive sity of Hong Kong, is enrolling 1,200 p tients in China and several other Asia countries to assess new uses for A traZeneca's drug Iressa. The treatme has a disappointing track record wit Western lung cancer patients but showing greater success in Asians, poss bly because of genetic differences in t populations. Ten years ago, such a tri would have been unthinkable. "The qua ity of the researchers wasn't hig enough," says Dr. Mok, "but now a goo number of sites in China are competent t carry out this research."

In general, recruitment for clinical tr als is easier in China. Because of povert and the lack of medical infrastructure i many parts of the country, patients ofte jump at the chance to enroll. They're wil ing to take part "because they don't hav any other option," explains Dr. Zhan For many reasons, both inspiring an sad, China may be the brightest hope fo breakthroughs against this disease.

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THEY WATCH YO
SURF THE WEB
THEY PLAGUE YO
WITH POP-UP AD
THEN THEY CRIPPL
YOUR HARD DRIVE

BY
BEN ELGIN

Consumers have strong opinions about Direct Revenue's software. "If I ever meet anyone from your company, I will kill you," a person who identified himself as James Chang said in an e-mail to Direct Revenue last summer. "I will f------ kill you and your families." Such sentiments aren't unusual. "You people are EVIL personified," Kevin Horton wrote around the same time. "I would like the four hours of my life back I have wasted trying to get your stupid uninvited software off my now crippled system."

Sifting through a stack of customer complaints in June, 2005, a Direct Revenue employee decided to tally the most frequently used words of aggression: "die" (103 times), "f------" (44), and "kill" (15). Douglas Kee, then Direct Revenue's chief of quality assurance (QA), fibbed colleagues in an e-mail that with all the death threats, it was a "good thing QA sits farthest away from the entrance."

According to angry consumers and the New York State Attorney General, Direct Revenue makes "spyware." These programs track where you go on the Internet and clutter your screen with annoying pop-up advertisements for everything from pornography to wireless phone plans. Spyware can get stuck in your computer's hard drive as you shop, chat, or download a song. It might arrive attached to that clever video you just nabbed at no charge. Web security company McAfee Inc. estimates that nearly three-quarters of all sites listed in response to Internet searches for popular phrases like "free screen savers" or "digital music" attempt to install some form of advertising software in visitors' computers. Once lodged there, spyware can sap a PC's processing power, slow its functioning, and even cause it to crash.

This explains the vitriol aimed at Direct Revenue. The company, located in a loft above a clothing boutique in New York's hip SoHo district, has been a pioneer in a seamy corner of the booming Net advertising industry. Although it is small by some corporate standards, having generated sales of about $100 million since its start in 2002, its programs have burrowed into nearly 100 million computers and produced billions of pop-up ads.

Direct Revenue's swift rise illustrates the intertwining of spyware and mainstream online marketing. The Web is the hottest game in advertising, but what's rarely acknowledged is the extent to which unsavory pop-ups boost the returns. Here's how it often works: Sellers of advertising, ranging from giant Yahoo! Inc. to much smaller networks, recruit clients, tally the clicks their ads generate, and charge accordingly. But then Yahoo and the other advertising companies sign up partners that distribute the ads beyond their own sites in return for a fee, and those partners sign up other partners. Down the line, a big piece of the business winds up in the hands of outfits like Direct Revenue, which disseminate the ads as pop-ups and share revenue with their more mainstream partners. Some advertisers say their messages have appeared in pop-ups without their permission. Others seek out pop-ups, and Direct Revenue frequently sells ads directly to such advertisers.

Spyware rakes in an estimated $2 billion a year in revenue, or about 11% of all Internet ad business, says the research firm IT-Harvest. Direct Revenue's direct customers have included such giants as Delta Air Lines and Cingular Wireless. It has sold millions of dollars of advertising passed along by Yahoo (page 45). And Direct Revenue has received venture capital from the likes of Insight Venture Partners, a respected New York investment firm.

SPREADING STRATEGY

MANY OF THOSE IMPRESSIVE ties have frayed or ripped apart recently as Direct Revenue has struggled to fend off a lawsuit filed in April by New York Attorney General Eliot Spitzer. The state court action alleges that Direct Revenue crossed a legal line by installing advertising programs in millions of comput-

ers without users' consent. Shining a light on the shadowy spyware trade, the suit asserts that the company violated New York civil laws against false advertising, computer tampering, and trespassing.

This article is based in part on more than 1,000 pages of Direct Revenue's internal e-mail and other documents included in court filings. *BusinessWeek* has reviewed additional documents and interviewed dozens of industry insiders, including 12 current and former Direct Revenue employees and executives.

The company denies any wrongdoing. In a filing in June, it calls the Spitzer suit "much ado about nothing" and defends its past practices as "commonplace" in the industry. It calls its programs "adware" and says it has notified consumers when putting the programs on their computers. It insists that some of the methods Spitzer assails "were long ago changed." And it argues that by accepting its ads, consumers get popular software applications free of charge that otherwise can cost up to $30 apiece.

In the wake of the litigation, Direct Revenue has shrunk in size, but it remains an important player on the spyware scene. Thousands of people still complain each month to Web security firms about new computer infections caused by Direct Revenue programs (although many users are baffled about what's causing the maladies). And a new generation of spyware purveyors of equal or greater potency is imitating Direct Revenue's strategies, infuriating customers, and threatening to taint the larger business of online advertising (page 47). Chances are you have some of their handiwork hidden within your hard drive right now.

SPITZER is suing on the grounds of false advertising, PC tampering, and trespassing

Spam King

DIRECT REVENUE'S ORIGINS trace the rise of what might politely be called one of the more freewheeling sectors of Internet commerce. The company's sales philosophy, according to current and former employees, was heavily shaped by Jesse Stein, a Wharton School-educated marketer whose successes before joining the company included selling VigRX, an herbal peni enlargement supplement. VigRX may sound familiar becau to win customers, Stein inundated e-mail in-boxes with spa promoting the product. In 2003, when the ABC News *20/* program identified what it said were the biggest online spa mers, it featured VigRX and showed one of Stein's e-mails. reveled in the notoriety. On his desk at Direct Revenue, Ste now 36, kept a framed *20/20* scre shot of his VigRX spam, former c leagues say.

His eventual boss, Joshua Abra came to online hawking from a d ferent angle. His family has a ri history of public service. Abran late father, Morris, was a civil righ activist in the 1960s who lat served as president of Brandeis Ur versity and U.S. ambassador to t U.N. under President George H.W Bush. Joshua's sister, Ruth, hea the Lower East Side Tenement M seum in New York.

In 1999 Joshua Abram helpe start Dash.com, a benign precurs to later spyware operations. Das attached an unobtrusive horizont bar to the bottom of a comput user's Web browser. As the us moved around the Internet, Das would note the sites being visite and offer relevant text ads inside th narrow bar. Dash went out of i way to ask users' permission to i stall the ad bar, and the compar even shared its fees with consume who made purchases. But Dash tactful text ads drew relatively few clicks, and its fee-sharing b came an administrative nightmare. As the Internet market in ploded in 2001, Dash folded.

Abram, known for wearing stylish suits amid a sea of techi grunge, kept developing ad software with several colleague They joined a broad post-bust move toward treating custome with less respect. One of the new spyware variants he helped cr ate was called VX2, which a former colleague and computer s curity professionals believe was named after the deadly, und tectable VX nerve agent. In 2002, Abram, a father of two an husband of a fashion-industry executive, started Direct Revenu His co-founders were fellow Dash alumnus Daniel Kaufman an a pair of data-mining entrepreneurs from a company calle Pipe9, Alan Murray and Rodney Hook. The next year, Direct Rev

POP-UP PRIMER

The rough-and-tumble spyware business has a vocabulary all its own:

ADWARE
Software that Internet advertising firms download to PCs with user permission. It tracks where you go and delivers pop-up ads tailored to sites you visit

SPYWARE
Software downloaded without consent. It, too, tracks where you go on the Internet and delivers pop-up ads—but some variants can cause your computer to crash

TORPEDO
Software code that a spyware company designs to knock competing programs off a computer's hard drive. This software has the ability to paralyze PCs

AURORA
The Direct Revenue spyware program that crippled thousands of computers in 2005, including those of some Direct Revenue employees and business partners

EBOLA
The nickname for spyware from Direct Revenue competitor CoolWebSearch. Like Aurora, it tended to disable host computers before it could generate ads

ue did business with and then acquired Stein's online ad ency, forming a spyware powerhouse. Stein declined to comment. The four founders didn't respond to numerous inquiries.

By early 2004, Direct Revenue, with Abram as CEO, had set-d into its SoHo loft, employing two dozen programmers and lespeople. Current and former staff members say the place had informal, often cynical atmosphere. The unsophisticated com-ter users subjected to Direct Revenue's ads had a nickname nong some staffers: "trailer cash."

Knowledgeable consumers can reduce the risk of spyware in-ction by using widely available security software and steering ear of free online goodies. Direct Revenue and its rivals—com-nies with such names as eXact Advertising and Zango—say ey employ "user agreements" that notify individuals when they e about to download their software. But the agreements typi-lly can be found only by clicking on links deep within separate gal agreements related to the online freebies. The documents nd to be lengthy and opaque. Large numbers of Internet users no lack adequate security software and fail to read the legalese ake themselves vulnerable.

PY VS. SPY

NCE EMBEDDED IN YOUR hard drive, spyware communicates a the Internet with the company that produced it. The compa-'s computer keeps track of your online meanderings and sends u pop-up ads relevant to the sites you visit. The travel-booking sites Travelocity and Priceline.com have both been direct customers of Direct Revenue. People who picked up Direct Revenue spyware and then perused flights on Travelocity might find their screens obstructed by a pop-up for Priceline, or vice-versa. The travel sites say they stopped doing business with the company earlier this year.

Direct Revenue and other ad software creators struggle to balance an impulse to pump out waves of profitable pop-ups against the danger of enraging consumers who lose control of their computers. "Most of these companies can't overcome their desire to make the most money right away," says Sam Curry, vice-president for product management at Computer Associates International Inc. in Islandia, N.Y.

From early on, a small group of programmers at Direct Revenue focused on how to protect their employer's programs once they were lodged in a computer, current and former employees say. The team called itself Dark Arts after the term for evil magic in the Harry Potter series. One of the biggest threats Dark Arts addressed came from competing software. The presence of multiple spyware programs can so cripple a computer that no ads manage to get seen.

Dark Arts crafted software "torpedoes" that blasted rival spyware off computers' hard drives. Competitors aimed similar weapons back at Direct Revenue's software, but few could match the wizardry of Dark Arts. One adversary, Avenue Media, filed suit in federal court in Seattle in 2004, alleging that in a matter of days, Direct Revenue torpedoes had cut in half the number of people using one of Avenue Media's programs. The suit settled

without money changing hands, according to an attorney for Avenue Media, which is based in Curaçao. "This is ad warfare," explains former Direct Revenue product manager Reza Khan. "Only the toughest and stickiest codes survive."

In light of the Dark Arts stratagems, Direct Revenue management in early 2004 procured from its lawyers a modified user agreement that would supposedly be shown to PC owners. Within the densely written seven-page document was a declaration that Direct Revenue "could remove, disable, or render inoperative other adware programs resident on your computer, which, in turn, may…have other adverse impacts on your computer."

Abram presented the new agreement to his troops with an impudence befitting the Dark Arts crew. "It's a lawyer-approved license to kill," the CEO said in a February, 2004, e-mail. He urged some restraint because at the time potential investors were examining the company: "I would think twice about going too aggressively on the offense during [due] diligence." But he added: "Obviously, if we find someone is slaughtering us in the interim, we should not wait to counter."

> "Your pop-up ads popped up a few porn sites while my 6- and 9-year-old children were using the computer."
>
> –*Consumer complaint to Direct Revenue*

"It was like a big game of *Dungeons & Dragons*," a current Direct Revenue manager says, and it was becoming lucrative. An ad software shop generally charges advertisers up to a penny a day for each computer that showcases its ads. A company with access to 10 million computers can make about $100,000 a day. With its "install base" soaring to more than 20 million computers by late 2004, Direct Revenue's annual sales rose 450%, to $39 million. Its four founders took home a combined $23 million, with Abram enjoying the biggest share: $8.1 million.

This cash geyser drew investors' attention. Insight Venture Partners, which has among its advisers Robert E. Rubin, former Treasury Secretary and now chairman of the executive committee at Citigroup, poured in $27 million, court filings show. Andrew J. Levander, a lawyer for Insight, says the firm's pre-investment due diligence "did not raise any issues concerning the lawfulness of Direct Revenue's disclosure and distribution practices." Rubin wasn't involved with the investment, Levander says. When Insight learns of complaints, he adds, it works with the company to address them.

Complaints were certainly not in short supply. "You have 24 hours to provide me with a removal tool for your piece of cra spyware program," Joe LoMoglio e-mailed the company September, 2004. "Your pop-up ads popped up a few por sites while my 6- and 9-year-old children were using the com puter." Reached by e-mail, LoMoglio says the company "r fused to respond."

As Direct Revenue surged in late 2004, its hyperactive sal force profited as well. Several top performers took home mo than $300,000 apiece that year, current and former emplo ees say, and a celebratory mood enveloped the fourth-floor a sales department. On Friday afte noons, employees opened bottles beer, and Paul Nute, a top sales exec tive, occasionally blasted the pop sor *Everybody's Working for the Weekend*

Nute had a trademark line for co porate sales pitches, according to cu rent and former sales employees. "It like crack," he would say. "Once yo try it, you'll keep coming back f more." Nute declined to comment.

By early 2005, Direct Revenue ha notched deals with JPMorgan Chas Delta, and the Internet phone compar Vonage, according to former sal staffers and Direct Revenue doc ments. Cingular Wireless spent mo than $100,000 a month at the peak of its relationship with D rect Revenue, current and former employees say. Direct Revenu put Cingular pop-ups in front of other phone companies' We sites and news sites such as the one affiliated with tech mag zine *Wired*. Vonage, meanwhile, was billed $110 for each cu tomer that Direct Revenue delivered, according to a sales repo from July, 2005. For that month, Direct Revenue billed Vonag for 287 new customers, or $31,570.

JPMorgan Chase confirms that it advertised with a Dire Revenue unit through the middle of last year, but says it w unaware of any spyware activity. Delta and Cingular decline to comment. Vonage didn't respond to inquiries.

No More Mr. Nice Guy

BY MID-2005, DIRECT REVENUE had grown to more than 1(employees, and its practices were drawing public notice. Blo gers, invoking the right to be free of uninvited ads, singled o Direct Revenue. Benjamin Edelman, a prominent Internet co

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YAHOO'S POP-UP CONNECTION

Yahoo! Inc. has become one of the spyware industry's main benefactors. Since 2003 the Sunnyvale (Calif.) titan has indirectly supplied ads to—and shared millions of revenue dollars with—Direct Revenue and its rivals.

Yahoo boasts hundreds of thousands of advertising clients. It shows their ads on its own site and, for additional payments, passes some along to other online publishers and distributors. Some of the distributors turn ads over to pop-up artists such as Direct Revenue. Fees are shared along the way.

These advertising daisy chains generally aren't disclosed, and piecing them together is difficult from the outside. Benjamin Edelman, a Web consultant and spyware watchdog, dug through logs of one of his test computers to trace the twisted trail between Yahoo and Direct Revenue. He followed the journey of a Dell Inc. ad carried by Yahoo last year: Yahoo sent the item to distributor InfoSpace Inc., which delivered it to Direct Revenue, which put it in a pop-up.

In another illustration of such connections, San Francisco distributor Walnut Ventures Inc. built a lot of its business by providing a bridge between Yahoo and Direct Revenue. In 2004, Yahoo ads accounted for 91%, or $11.6 million, of Walnut's revenues. Approximately one-third of those sales came from pop-ups that were generated by Walnut's biggest downstream partner, Direct Revenue, according to a federal securities filing last year. InterSearch Group Inc., which acquired Walnut in 2004, terminated its relationship with Direct Revenue in April.

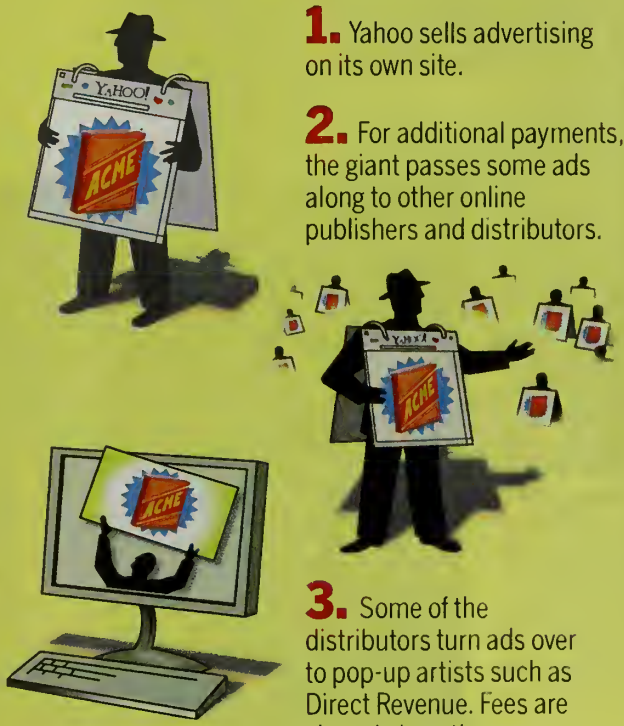
A former sales executive at Yahoo says the company knew that some of its ads were surfacing in spyware pop-ups. "It was a dial we could turn if we needed a little more revenue," the ex-executive says. Court and regulatory filings reveal that even with distributors in the middle, the Yahoo-Direct Revenue connection generated hundreds of thousands of dollars a month for each company for much of 2004 and 2005. Direct Revenue wanted to forge a closer relationship with Yahoo, according to one current and one former Direct Revenue manager. But after a flurry of phone calls from Direct Revenue representatives, Yahoo refused.

Yahoo officials say they can't comment specifically because of pending litigation between the company and some of its advertisers. "Yahoo takes the quality of its search-ad distribution network very seriously," spokeswoman Gaude Paez says. "Yahoo has strict distribution partner guidelines and has terminated many publishers for failing to comply with those guidelines."

Dell says it doesn't allow its ads to appear in spyware pop-ups but wouldn't comment on its relationship with Yahoo. InfoSpace says it focuses intently on ad quality and discontinued its relationship with Direct Revenue last year.

–Ben Elgin

HOW YAHOO! HELPS FUEL THE SPYWARE BUSINESS



1. Yahoo sells advertising on its own site.

2. For additional payments, the giant passes some ads along to other online publishers and distributors.

3. Some of the distributors turn ads over to pop-up artists such as Direct Revenue. Fees are shared along the way.

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> "Thanks to you, and your so-called 'safe' and 'compliant' software, my computer is now nearly inoperable!... The use of my computer is essential as I am a single mother dependent on finding work, and now I'm unable to even print my résumé.... You are despicable..."
>
> –*Consumer complaint to Direct Revenue*

sultant and spyware foe in Cambridge, Mass., tried to shame advertisers away from Direct Revenue by displaying on his site the names of companies that appeared in Direct Revenue pop-ups. Jules Neuringer, owner of Portronix, a Brooklyn (N.Y.) computer-service firm, says that during this period about a dozen of his small-business clients complained about Direct Revenue spyware. Of these, he says he "was never able to bring an infected computer back to pristine operating condition."

Direct Revenue insiders knew they were alienating consumers and even made tentative moves to clean up their act, court filings show. But when the result was fewer people getting stuck with its software, Direct Revenue pulled back from reforms.

In early 2005 the company was bundling its products with a file-sharing program called Morpheus, which users could download onto their computers. Morpheus required that Direct Revenue make its software easy to spot in a computer's "Add/Remove" panel, which is the registry where a user can find most legitimate software and delete it. Direct Revenue agreed at first but after a few months noticed that thousands of new users it gained via Morpheus were quickly deleting the ad software. Kaufman, a co-founder of Direct Revenue, sent an e-mail to colleagues in February, 2005, saying the company should drop the Mr. Nice Guy routine. "We need to experiment with less user-friendly uninstall methodologies," he wrote. The distribution agreement with Morpheus ended within three months.

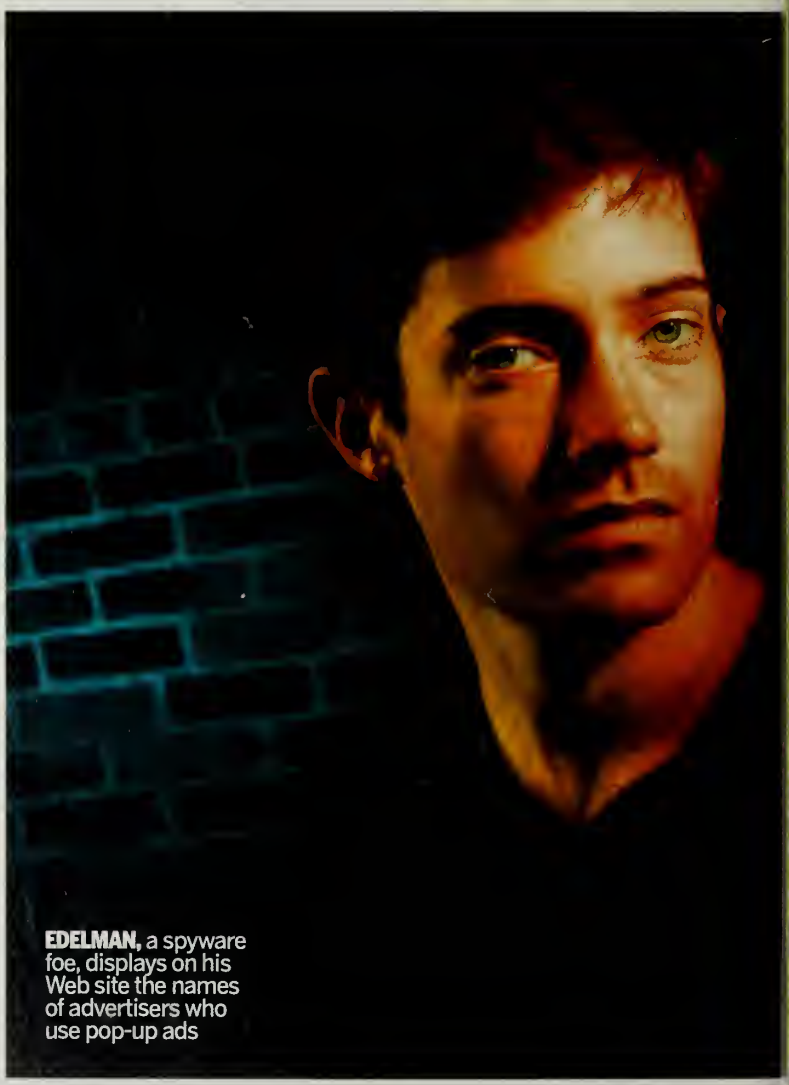
Mass Paralysis

THE SAME AMBIVALENCE was evident in April, 2005, when Direct Revenue released a concoction known as Aurora. The program clearly labeled ads as coming from the company, a gesture designed to build credibility. But Aurora had powerful features that fought off competing spyware and security programs. The company also raised the number of pop-ups it sent users to as many as 30 a day.

Disaster ensued, as Aurora paralyzed thousands of computers. Matt Oettinger, who ran media operations at Fastclick, an advertising network that bought ads from Direct Revenue, found his home PC afflicted by Aurora, e-mails in court filings show. In June he ordered all Fastclick ads disentangled from Aurora. Branko Krmpotic, the managing director of Technology Investme Capital Corp. (TICC), which had i vested $6.7 million in Direct Re enue, also caught the Aurora bug a couldn't kill it, according to e-mai Eventually, Direct Revenue had send its customer support director fix Krmpotic's machine. After rece ing complaints about Aurora, Insig Venture, another major investor, t the company to remove Insigh name from the Direct Revenue W site. Fastclick declined to comme Krmpotic didn't return calls.

Even Aurora's creators fell victim as the program froze co puters at Direct Revenue. One sales staffer, Judit Major, doc mented receiving more than 30 pop-up ads in one day, accor ing to e-mails. Her computer crashed four times. "We a serving WAY TOO MANY pops per hour," wrote Chief Techn ogy Officer Daniel Doman in a June e-mail to the compan brass. "If we overdo it, we will really drive users to get us t hell [off] their machine. We need to BACK OFF or we will k our base."

By then consumer complaints were pouring in to Attorn



EDELMAN, a spyware foe, displays on his Web site the names of advertisers who use pop-up ads

YOU CAN'T KEEP A BAD SCHEME DOWN

The spyware scourge is only getting worse. Worried about angry consumers and legal troubles such as those facing Direct Revenue, some spyware companies are changing their ways—for example, by asking computer users more clearly whether they understand they will receive pop-up ads. But new and more nefarious online advertising outfits are cropping up, many of them based overseas, says C. David Moll, chief executive of Webroot Software inc., a Boulder (Colo.) company that makes programs to fight spyware. "Trench warfare, that is spyware today," Moll says.

Direct Revenue rival 180Solutions Inc. launched a reform campaign last year. Now renamed Zango Inc., the Bellevue (Wash.) company sued seven of its distributors, accusing them of installing its programs, which it calls "searchware," without obtaining permission from PC owners.

But some online security analysts question whether Zango was serious about changing the way its software is distributed. The company has voluntarily dropped its suit in King County (Wash.) Superior Court. Rather than litigate, Zango says it is protecting consumers by simply cutting off unprincipled intermediaries. Still, roughly 600 of what it calls "publishers" continue to market its advertising programs. With those numbers, skeptics say, some of the middlemen are bound to try to use sneaky tactics to install Zango on PCs. "When you have a huge number of affiliates, it's almost impossible to police them," says Ed English, chief technology officer for anti-spyware products at Tokyo's Trend Micro Inc.

If you know where to look, you can watch the spyware brands proliferate. Webmaster-Money.org provides a veritable supermarket of 26 pop-up programs, sporting names like GimmyCash!, MatCash, and MakeThemCry. Webmaster-Money aims this information at other Internet-based businesses that are eager to form alliances with companies that make these programs. Webmaster-Money shoppers are invited to package their software with the spyware programs. The businesses pay as much as 80¢ each time one of these bundles is installed on a consumer's computer. Describing its spyware offerings, Webmaster-Money awkwardly advises visitors that

"sometimes are these programs anoying [sic] for surfers, but you can be surprised how much they can make for you."

Radovan Pokorny owns Webmaster-Money, which is based in the Czech Republic. Reached by telephone, Pokorny, 28, says he knows that some of the programs on his site may be spyware. In fact, he says he receives commissions of up to 10% for referring clients to spyware providers. "I'm trying to make money by telling other people how to make money on the Internet," he explains.

> **"Companies like you should be ashamed of your lives. If God exists, He hates you."**
>
> *–Consumer complaint to Direct Revenue*

Setting up shop in jurisdictions where the legal system is looser than in the U.S. has become a common tactic for players in the spyware industry. Atlanta-based Internet Security Systems Inc. says that it's tracking 15 variants of spyware distributed by one company, Neoteric Ltd., based on the British Channel Island of Jersey. "Some companies that realize they may be caught and prosecuted, but do not want to change their practices, are moving offshore," says Kenneth M. Dreifach, former head of the Internet bureau in the office of New York Attorney General Eliot Spitzer. Neoteric did not respond to requests for comment.

Easy profits are attracting more sinister operators. Last August, police in Morocco, armed with intelligence from U.S. authorities, arrested Farid Essebar on suspicion of creating "worms," malicious programs designed to cripple computers. The FBI believes that Essebar, 24, created the worms, known as Mytob and Zotob, that last summer gummed up thousands of PCs in U.S. congressional offices, at *The New York Times*, and at industrial equipment manufacturer Caterpillar Inc., among other companies. Code written into the Zotob worm lowered PCs' security settings, allowing spyware to download more easily to those computers. Essebar was paid as much as 6¢ per installation by spyware operators, according to British e-mail security firm MessageLabs Ltd. FBI officials say Essebar was recently released, although he has been charged with credit-card fraud in Morocco. He couldn't be reached for comment.

As one alarming spyware scheme gets shut down, another one crops up, according to Jeremy Pickett, security practices manager at Sana Security Inc. in San Mateo, Calif., adding: "There is still more suffering to come."

–Brian Grow

General Spitzer's office. He filed suit in April, after his staff had hauled away 150 boxes of the company's e-mails. Spitzer alleges that he found numerous examples of Direct Revenue spyware downloaded with misleading user agreements or no disclosure at all. In many cases, the download was performed by a distributor on behalf of Direct Revenue, but company executives repeatedly conceded in e-mail that users were in the dark about how its programs got into their computers. This, Spitzer argues, amounts to illegal deception.

NEURINGER says he can't bring a PC infected by Direct Revenue back to its pristine state

PERSISTENT HEADACHES

A DIRECT REVENUE spokesman, Michael Spinney, says the company is "mystified" by Spitzer's allegations. It cleansed its practices more than nine months ago, Spinney says, and now puts its name on all its pop-up ads. It also now makes its software available for deletion in a computer's Add/Remove Programs registry and has limited its use of distributors. Before these changes, Spinney asserts, Direct Revenue employed practices common in its industry. He wouldn't comment on Spitzer's individual allegations.

The anti-spyware activists and computer security firms confirm that Direct Revenue has dropped its most destructive programs, such as Aurora. But they emphasize that the company continues to cause serious headaches. Tokyo's Trend Micro Inc. offers an online service that scans customers' troubled computers. In April it identified Direct Revenue's spyware as the culprit in 9,400 computer scans. That's down from 14,000 in January, but it represents a substantial level of annoyance. "Direct Revenue is still on everyone's top 10" of reviled spyware companies, says Anthony Arrott, Trend Micro's spyware research manager.

> "AHHHH. I've got a knife to my throat, and if I get another pop-up tonight I am going to kill myself."
>
> *–Consumer complaint to Direct Revenue*

Deborah Maradei-Ugel, a loan officer in Santa Clarita, Calif., says she receives more than 20 pop-ups a day on her home computer as a result of Direct Revenue spyware. She complained to the company, but removal instructions it sent her are impossible to follow, she says. Her machine frequently stalls and requires restarting. "You hit your computer," she fumes, "but it doesn't help."

The way Direct Revenue describes its software during the download process remains vague and misleading, Edelman and other critics say. The company now bundles ad programs with Kazaa, an online service offering music and other digital content. Kazaa gives users a choice between a $30 version of its program and a free version labeled "ad supported." But few dinary consumers would understand that ad-supported mea they get separate software from Direct Revenue that will mo itor them online and serve a steady stream of pop-ups, Edelm says. Kazaa declined to comment.

Direct Revenue has lost business and reduced its headcoun a couple dozen employees. The four founders still own 55% of t company, according to Spitzer's filing, and Abram is still se around the office in his sharp suits. But he no longer serves CEO. Sales gurus Stein and Nute have moved on to another ternet venture. Many major companies, such as Cingular and hoo, have severed connections with Direct Revenue. But the a of others, including Vonage, continue to appear in Direct Re enue pop-ups. Insight and TICC remain investors.

Among Direct Revenue's alumni, pride over technical cu ning mingles with regret for exasperating so many compu users. After waffling on the issue during a long interview, c former Dark Arts wizard sighs and sums up his version of t company credo with an elegiac observation by abolition Frederick Douglass: "Find out just what any people will qui ly submit to and you have found out the exact measure of justice and wrong which will be imposed upon them." ■

–With Brian Gr

The Cloak-and-Data World of Spyware

Uncovering "supertargeting": Computer users aren't the only victims of spyware. Some advertisers are subject to this little-known Direct Revenue practice.

The gadfly: How a curious computer technician gave Direct Revenue big headaches.

How to get rid of it: There are ways to eradicate spyware and recover control of your computer.

The story behind the story: A podcast interview with Ben Elgin by Executive Editor John A. Byrne

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The Best Medical Care In the U.S.

How Veterans Affairs transformed itself—and what it means for the rest of us

BY CATHERINE ARNST

RAYMOND B. ROEMER, 83, has earned his membership in "the greatest generation." A flight engineer during World War II, his B-24 was shot down over Potsdam during a bombing run. He managed to parachute out, but the jump landed him in enemy territory. Roemer spent 11 months in a German POW camp until he was liberated by General George S. Patton's troops in April, 1945.

A month later he came home to Buffalo with a Purple Heart and a few crushed vertebrae from that parachute jump. He married his high school sweetheart, started a successful metal-fabricating business, and signed up for health benefits with Blue Cross/Blue Shield. He can afford to be treated at any of some 20 well-regarded hospitals in the area, but Roemer has made what what may seem a bizarre choice. He goes to the Veterans Affairs Medical Center in Buffalo, a hulking, gray edifice first opened in 1950. He doesn't go just for his service-related injuries, either. His primary care doctor is at the VA, he fills his prescriptions there, and he uses the hospital for his vision and hearing needs. He even persuaded his 59-year-old son and business partner, Nicholas, a Vietnam War vet, to enroll with the VA.

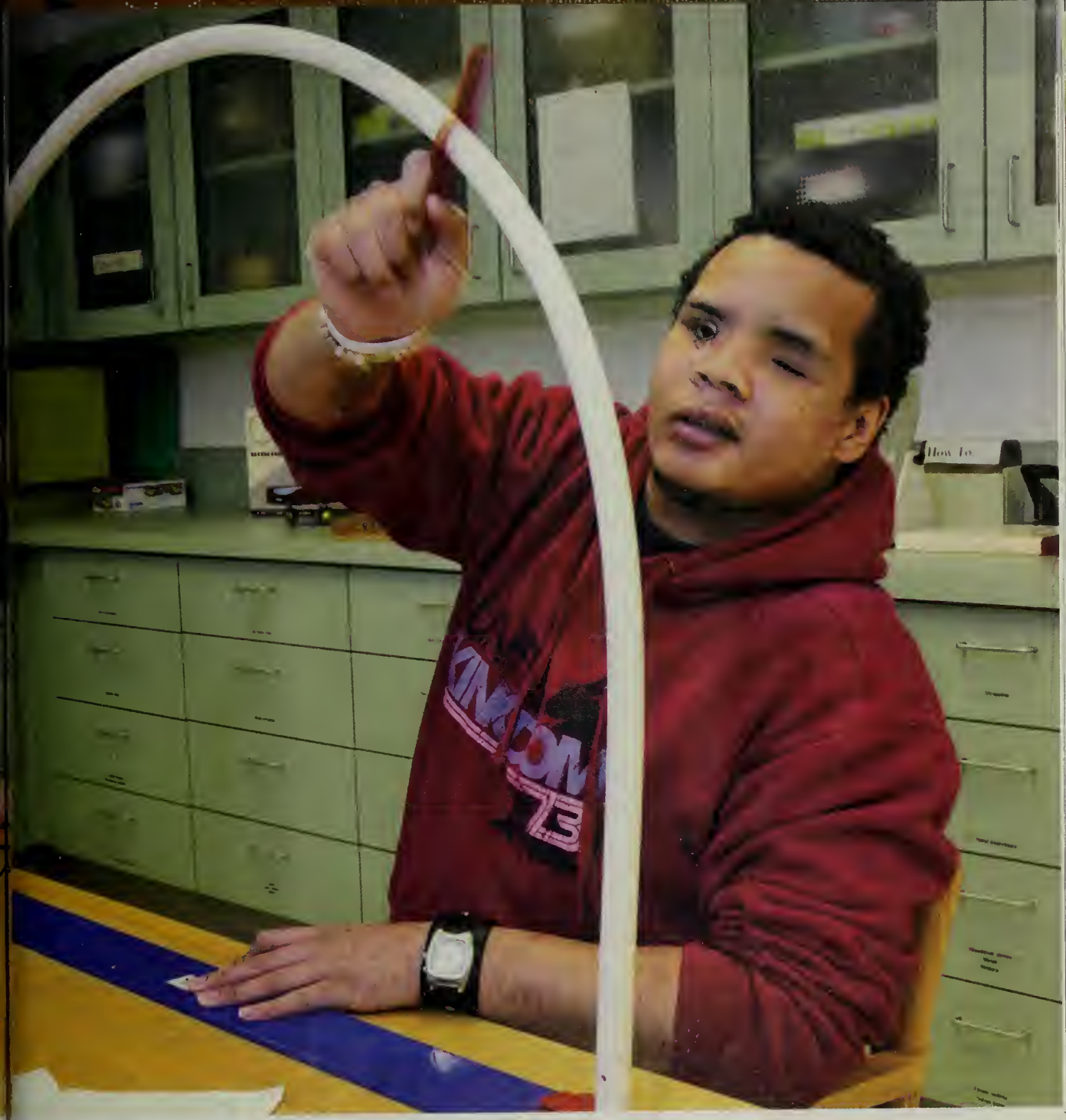
Every day some 1,400 patients pass through the Buffalo VA's unprepossessing entrance, into what many might assume is a hellish health-care world, understaffed, underfunded, and uncaring. They couldn't be more wrong. According to the nation's hospital-accreditation panel, the VA outpaces every other hospital in the Buffalo region. "The care here is excellent," says Roemer. "I couldn't be happier, and my friends in the POW group I belong to all feel the same."

LOWER COSTS, HIGHER QUALITY

ROEMER SEEMS TO HAVE stepped through the looking glass into an alternative universe, one where a nationwide health system that is run and financed by the federal government provides the best medical care in America. But it's true—if you want to be sure of top-notch care, join the military. The 154 hospitals and 875 clinics run by the Veterans Affairs Dept. have been ranked best-in-class by a number of independent groups on a broad range of measures, from chronic care to heart disease treatment to percentage of members who receive flu shots. It offers all the same services, and sometimes more, than private sector providers.

According to a Rand Corp. study, the VA system provides two-thirds of the care recommended by such standards bodies as the Agency for Healthcare Research & Quality. Far from perfect, granted—but the nation's private-sector hospitals provide only 50%. And while studies show that 3% to 8% of the nation's prescriptions are filled erroneously, the VA's prescription accuracy rate is greater than 99.997%, a level most hospitals only dream about. That's

Because the VA treats patients for life, it has an incentive to invest in **preventive care,** reaping the benefit of lower long-term costs. And its **advanced patient-records database** has nearly eliminated drug errors



AFTER IRAQ Therapist Daniela Lita with vet Poole, who is recovering from injuries suffered in a roadside bomb attack

gely because the VA has by far the most vanced computerized medical-records stem in the U.S. And for the past six ars the VA has outranked private-sector spitals on patient satisfaction in an an- al consumer survey conducted by the tional Quality Research Center at the iversity of Michigan. This keeps hap- ning despite the fact that the VA spends average of $5,000 per patient, vs. the tional average of $6,300.

To much of the public, though, the VA's age is hobbled by its inglorious past. r decades the VA was the health-care stem of last resort. The movies *Coming me* (1978), *Born on the Fourth of July* (1989), and *Article 99* (1992) immortalized VA hospitals as festering sinkholes of substandard care. The filmmakers didn't exaggerate. In an infamous incident in 1992, the bodies of two patients were found on the grounds of a VA hospital in Virginia months after they had gone missing. The huge system had deteriorated so badly by the early '90s that Congress considered disbanding it.

Instead, the VA was reinvented in every way possible. In the mid-1990s, Dr. Kenneth W. Kizer, then the VA's Health Under Secretary, installed the most extensive electronic medical-records system in the U.S. Kizer also decentralized decision-making, closed underused hospitals, reallocated resources, and most critically, instituted a culture of accountability and quality measurements. "Our whole motivation was to make the system work for the patient," says Kizer, now director of the National Quality Forum, a nonprofit dedicated to improving health care. "We did a top-to-bottom makeover with that goal always in mind."

Keeping that goal in sight will be challenging as more and more Iraq vets come

home. Some Sunbelt facilities are already overcrowded as the veterans' population ages and moves south. Much also depends on the amount of money Washington is willing to allocate to veterans' care. Kizer complains that budget allocations did not keep pace with inflation for the entire five years he was at the VA.

MIGHTY FORCE FOR CHANGE

THE VA'S RADICAL overhaul has caught the attention of health-care policy wonks, who have in turn sung the system's praises in prestigious medical journals. Last year the Canadian journal *Healthcare-Papers* devoted an entire issue to the lessons other systems can take from the VA's transformation.

The biggest lesson? A nationwide health-care network that gets its funding from a single payer can institute mighty changes. Proponents of national health-care reform extrapolate even further. "The VA proves that you can get better results with an integrated, organized, national health-care system," says Dr. Lucian Leape, a professor at the Harvard School of Public Health and a leading expert on hospital safety. "We will not achieve even close to the level of quality and safety we need [in the U.S.] as long as we have individual practitioners and hospitals doing individual things."

The VA is, in many ways, the exact opposite of America's fragmented private-sector system, where doctors work for hospitals as independent contractors, and third-party insurers pay the bills as they see fit. By far the largest health-care network in the U.S., the VA serves 5.4 million patients—double the number it treated 10 years ago. All veterans are eligible for free or low-cost care, paid for out of the federal budget. The 2006 allocation comes to $35 billion.

Not having to rely on piecemeal insurance payments means the VA can finance large-scale improvements such as the electronic medical-records system, up and running in all of its facilities since 2000. In contrast, only some 20% of civilian hospitals have computerized their patient records. Because the VA is a nationwide health-care system, its electronic network is national, which means all of its facilities can share data. When hospitals were evacuated from New Orleans during Hurricane Katrina, the VA's patients were the only ones whose medical records could be accessed immediately anywhere in the country.

The VA's charter also confers some unique advantages. Because it treats patients throughout their lives, it can invest in prevention and primary care, knowing it will reap the benefits of lower long-term costs. Because the government pays the bills, the VA doesn't have to waste time or money on claims-related paperwork. Unlike Medicare, the VA is allowed to negotiate prices with drug companies and other suppliers, and it uses that power aggressively. The consumer group Families USA estimates that Medicare Part D enrollees, on average, pay 46% more than the VA for the same drugs.

The VA also gets to keep any money it saves through cost efficiencies. In the private sector the savings flow back to whoever is paying the bills. And because its doctors are salaried employees, the VA can implement systemwide changes without having to persuade outside doctors to go along. That doesn't mean it's settling for second-rate physici
Among the VA staff is a Nobel prize v
ner, and clinical research is condu
throughout the system. The Buffalo
recently hired one of the city's top
geons, Dr. Miguel A. Rainstein, as c
of surgery. He had spent 26 years in
vate practice, where, he concedes,
made a lot more money, but he
ready for a lifestyle change. "I feel th
has always gotten a bad rap. They h
an excellent medical staff here, in
gery and in specialties."

The staff is happier, too, since muc
the bureaucracy that once hobbled the
ganization has been streamlined. K
ended Washington's centralized d
sion-making and set up a military-like
ganization of 22 regional divisions.
doctors don't have to worry as m

Winning Scorecard

Hospitals in the Veterans Affairs system outpace those in the private sector by many measures

QUALITY of Care

The latest Rand Corp. study found that VA patients, on average, received about two-thirds of the care recommended by national standards, compared with just half for patients at a sample of the nation's other hospitals. Here's the breakdown:

HEALTH INDICATOR	VA SCORE*	NATIONAL SAMPLE**
Overall	67%	51%
Chronic care	72	59
Lung disease	68	59
Heart disease	73	70
Depression	60	62
Diabetes	73	41
Hypertension	73	65
High cholesterol	68	59
Osteoarthritis	68	57
Preventive care	68	44
Acute care	53	55
Screening	68	44
Diagnosis	73	41
Treatment	68	41
Follow-up	73	59

*596 VA patients **992 patients at non-VA hospitals
Data: Rand Corp., Agency for Healthcare Research & Quality

Patient SATISFACTION

For the sixth year in a row, veterans in 2005 were happier than other patients with their health care.

	VA	PRIVATE SECTOR
Inpatient	83*	73
Outpatient	80	75

*Out of 100 **Data:** American Customer Satisfaction Index

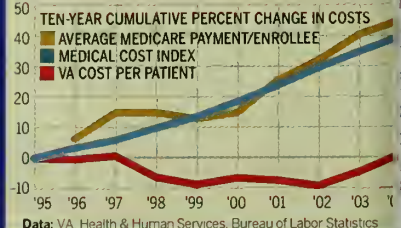
TECHNOLOGY Use

The VA has the most advanced electronic-records system in the U.S.

PERCENTAGE OF NEW-DRUG AND PROCEDURE ORDERS ENTERED ELECTRONICALLY	
VA	94%
Academic medical centers	30
Nationwide	8

Data: Commonwealth Foundation

Cost EFFICIENCY



Data: VA, Health & Human Services, Bureau of Labor Statistics

FATHER AND SON Ray and Nick Roemer can afford private doctors but choose the VA

ut malpractice lawsuits, since governnt agencies are somewhat protected. t made it easier for the VA to go out on imb in 2005 and institute a syswide policy of apologizing to patients medical errors—an act of contrition ely done in the private sector. "Most ilies just want to hear an apology en a mistake is made," says Dr. athan B. Perlin, Kizer's successor as der Secretary for Health.

The "Sorry Now" program, as it's ed, is an extension of Kizer's plan to nsform the VA from an unaccountable eaucracy into a transparent system t constantly seeks to improve care. ey've adopted a culture of patient safeand quality that is pervasive," says en Davis, president of Commonwealth Fund, which studies health-care issues.

The centerpiece of that culture is VistA, the VA's much praised electronic medical-records system. Every office visit, prescription, and medical procedure is recorded in its database, allowing doctors and nurses to update themselves on a patient's status with just a few keystrokes. In 1995, patient records at VA hospitals were available at the time of a clinical encounter only 60% of the time. Today they are 100% available. Some 96% of all prescriptions and medical orders, such as lab tests, are now entered electronically. The national comparison is more like 8%. "One out of five tests in a civilian hospital have to be repeated because the paper results are lost," says Veterans Affairs Secretary R. James Nicholson. "That's not happening in our hospitals." VistA is a big reason why the VA has held its costs per patient steady over the past 10 years despite double-digit inflation in health-care prices.

VistA has also turned out be a powerful force for quality control. The VA uses the data gathered in its computers to pinpoint problem areas, such as medication errors. The network also allows it to track how closely the medical staff is following evidence-based treatment and monitor deficiencies. Such tracking pays off. When Rand did an extensive study comparing quality of care at the VA with private-sector hospitals, it found that performance measurement played an important role in helping the VA score higher in every category except acute care, where it came in about even.

All of these changes are evident at the Buffalo VA. The patients in its waiting rooms hint at the hospital's special mission—a mixture of frail old men, Vietnam era vets with ponytails and tattoos, and a scattering of young, clean-cut guys recently back from Iraq. The few women are usually wives since only 7% of veterans are female. A nurse meets with each patient on arrival, updating electronic records so that the doctor can get up to speed immediately. (Patients can also access their own records if they want, a rare option in most medical-records systems.)

> "The care here is excellent. **I couldn't be happier,** and my friends in the POW group I belong to all feel the same"
>
> *–Raymond Roemer, World War II vet*

At the hospital pharmacy, prescriptions are doled out by robotic devices—one reason the organization is able to hold copays at $8. Each bottle of medicine carries a bar code that is scanned by the computer. If a patient is allergic or takes a conflicting drug, the system will sound an alarm. Similar bar codes are affixed to patient ID bracelets to protect against the

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ong patient getting a procedure, a nmon mixup in hospitals. The bar le idea was thought up by a VA nurse Topeka, Kan., who noticed that rental s were checked in with portable bar de scanners and figured the same tech- logy could be used in hospitals.

ECTRONIC HOUSE CALLS

. JOHN SANDERSON, the Buffalo VA's ector of medicine, clicks on to VistA as on as he enters the clinic each morning check the progress of his patients. nderson is a primary care doctor, so he ys point man in the team of specialists signed to each vet according to the pa- nt's needs. He meets with an elderly n with severe asthma, takes a quick k at his electronic records, and learns t the patient has not yet had a pneu- nia shot. That's a big issue at the VA. e organization has cut hospitalizations 4,000 patients a year since its pneu- nia vaccination rate went from 29% in 95 to 94% last year.

Sanderson also decides the patient eds to see a pulmonary specialist and ranges an appointment with one on the ot so the vet doesn't have to make a sec- d trip. Such consideration for the pa- nt is evident throughout the hospital. every department of the giant building ngs a poster with the name, photo, and one number of the supervisor, inviting tients to call with questions or com- aints. The hospital is determined that patient remain in the waiting room ore than 15 minutes. Sanderson would e to get that down to five. After every tpatient visit and inpatient release, a ffer follows up with a call a few days er for feedback on the vet's experience d to make sure there are no problems.

Sanderson is able to spend more time th his patients because he spends less ne record-keeping than his counter- rts in private practice. That lets him fo-

PLAYBOOK: BEST-PRACTICE IDEAS

Medical MAKEOVER

The Veterans Affairs health network went from one of the worst in the nation to the best in just 10 years. It has some unique attributes that can't be duplicated at civilian hospitals. Still, other providers —and industries—can learn a lot from the military's rulebook.

HIRE LEADERS WHO LOVE A CHALLENGE When Dr. Ken Kizer became Health Under Secretary in 1994, Congress handed him a mandate to fix the VA, and he ran with it. "There was a universal consensus back then that if there was a single organization that couldn't be changed, it was the VA," he says. "I decided I would make this a model system, a case study for radical change." Kizer is often described as hard-nosed, abrasive, and brilliant. He got the job done in just five years. But Congress forced him out in '99.

ESTABLISH A CULTURE OF QUALITY Kizer decided from the outset that the VA would focus on quality of patient care above all. Every change, from the practice of medicine to the way prescriptions are filled, was redesigned with that goal in mind. "Culture of quality" is not just a meaningless slogan at the VA. Practices and outcomes are evaluated constantly, and staffers throughout the system meet regularly to discuss ways to improve patient care.

IT'S THE TECHNOLOGY, STUPID The VA has by far the most advanced electronic medical-records (EMR) system in the U.S., called VistA. Every one of the VA's facilities is linked to the national database, and every patient protocol and interaction is recorded. The resulting efficiencies and error reductions have more than covered the cost of implementing VistA. Also, the VA now has the data in hand to determine how well it is meeting its quality benchmarks.

cus on preventive care, and particularly diabetes prevention. Some 23% of the VA's patients have diabetes, and without close monitoring they can go on to develop a range of complications. The VA scored very high in the Rand study on diabetes care—70 out of 100, vs. 57 for the private sector. But to keep patients from developing diabetes in the first place, the VA offers overweight patients the opportunity to join a weight-management program that pairs them with a nutritionist. Few insurers will pay for such prevention in a civilian setting. To Sanderson, preventive care is just one reason he is sure the changes at the VA "have saved thousands of lives over the years."

Staffers in Buffalo embrace the hospital's high level of commitment to patient care in part because many of them are veterans themselves. Diane DiFrancesco, a nurse in the intensive-care unit, is also a flight nurse in the U.S. Air Force Reserve. Her husband, a pilot in the reserves, is on his third tour of duty in Iraq. She has been at the Buffalo VA since 1987, a longevity typical at the facility, where the annual turnover rate is half that of other area hospitals. "People here really want to help the vets," she says. "Once you get used to

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ca

it here, it's hard to work anywhere else."

This Band of Brothers mentality goes a long way toward attracting and keeping the VA's unique group of patients. "I've never been very comfortable in hospitals, but I like the idea that the patients here and I have something in common," says Nick Roemer, Ray's son, who first used the Buffalo VA three years ago when he hurt his wrists. He has private insurance but figured it would be cheaper and faster to come to his father's caregiver. "You can talk to people here. They're like you."

The VA's mission brings with it some special burdens, however. Its patients are generally older, poorer, and sicker than those in civilian hospitals; there is also a higher prevalence of mental illness and addiction. And it has large numbers of patients with a malady that is much less common in civilian hospitals: post-traumatic stress disorder (PTSD).

It was the PTSD program that persuaded Steve to enter the fold. A 40-year-old police officer in the Buffalo area who asked that his last name not be used, Steve has been a sergeant in the reserves for 21 years, serving in Afghanistan, Bosnia, and Panama, and Iraq in 2004. When he returned from Iraq, he couldn't sleep and constantly felt anxious. He resisted visiting a VA facility because of negative impressions carried over from the early '90s, but he figured "a civilian doctor would have no clue. They don't understand where we're coming from." At the VA he felt he could be treated properly and comfortably. "To be honest, I don't want to bring it up with anyone outside the vet community." Now he's sending literature about the PTSD services to everyone in his unit who's still in Iraq.

Those returning vets are one of the biggest challenges looming for the VA. It recently reported that the number of PTSD cases has doubled since 2000, to an all-time high of 260,000. The Iraq war has also left vets with injuries that are horrendous even by wartime measures because battle field medicine can treat traumas that in past wars would have meant certain death. In World War II, there were two to three soldiers wounded for every one killed. In Iraq, 9 to 10 are wounded for each killed.

Marine Corporal Jason Poole, 23, is living proof of the improved chances of survival and the advanced medicine offered by the VA. The native of Bristol, England, now a U.S. citizen, was on his third tour in Iraq in 2004, 10 days shy of coming home, when his patrol was hit by a roadside bomb that left him in a coma for two months. Shrapnel went through his left ear and out his left eye. He was unable to walk, talk, or breathe without a tube. Treated at the brain trauma unit of the VA hospital in Palo Alto, Calif., one of four VA polytrauma clinics for the severely wounded, Poole has had nine reconstructive surgeries in two years. He still gets physical therapy, but he is now walking, talking, and taking classes at a community college. "I've been treated amazingly here," he says. "Everyone has been working so hard for me."

The VA is opening 22 more polytrauma clinics to care for the growing numbers of soldiers with severe injuries. Most will eventually be treated at standard hospitals like the one in Buffalo, and that could send the VA's costs skyrocketing.

It doesn't help that the VA must worry about getting shortchanged by Washington. President George W. Bush wants to hold down costs by raising eligibility requirements for vets. So far, Congress has rebuffed him. That doesn't mean Capitol Hill is always on the VA's side, though. Kizer, the turnaround's architect, was for out in 1999 when Congress refused to confirm him after he closed hospitals in districts. Dr. Dennis S. O'Leary, presiden the Joint Commission on Accreditatior Healthcare Organizations, praises Nich son and Perlin for sticking with Kizer's forms. But he warns that "the most co mon reason hospitals go into the tank change in leadership." Since the VA is as fected by politics as any other federal e ty, that will always be a concern, he say

It's not a concern yet, and civilians taking notice of the military way of m icine, with some hospitals using versi of VistA. The VA's other advantages n not be as easy to adapt, but as Harvar Leape says, "the VA is a dramatic exa ple of what can happen if you have will and the leadership to make char happen."

> "Once you get used to it here, **it's hard to work anywhere else"**
>
> *–Diane DiFrancesco, intensive-care nurse at the Buffalo VA Medical Center, where the staff turnover rate is half that of other local hospitals*

> **"Thousands of lives"** have been saved by the VA's focus on preventive care
>
> *–Dr. John Sanders director of medic at the Buffalo*

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*Source: Current Analysis, Inc.

Small Print Jobs For Peanuts

VistaPrint's online design tools for clients and whizzy presses can slash costs by 80%

BY DAVID KILEY

THE LAST PLACE YOU would expect to see an ad for adult film star Erika Caliente is anywhere near announcements for "Luke and Jacqui's Wedding" in western Michigan. Except, that is, if you visit VistaPrint Ltd.'s Windsor (Ont.) printing plant. Here, postcards hawking Caliente's show at Randy's Bar & Entertainment in Queens, N.Y., are printed on the same 40-by-28-inch piece of card stock as the happy couple's save-the-date mailing. At traditional printers, batching these two jobs would be unlikely. For VistaPrint, it's no problem—and that's shaking up the $19 billion small-biz printing industry.

By using Web technologies to standardize the piecemeal world of printing, VistaPrint is putting slickly finished products within the reach of small businesses. VistaPrint does that by combining online design tools for customers with sophisticated printing systems. This eliminates high-cost design and makes the most of every scrap of paper and dram of ink. The result: Prices that can be 80% to 90% cheaper than at custom print shops. Now, VistaPrint churns out 15,000 orders a day for 7 million customers and claims 80% of the online small-business printing market. "They're transforming the business with a truly disruptive model," says Mark May, an analyst at Needham & Co.

It's a classic case of using tech to create a market. Individuals and small businesses are often priced out of professional-looking printing. Graphic designers can run amok with customized borders and pricey paper, pushing up costs by several hundred dollars. The alternative for most is desktop printing. Founder and CEO Robert Keane's business model is based on the idea that 90% of professional printing can be standardized.

NO WASTE
Software figures out the best way to batch jobs

It's tough to argue the point when a full sheet of print work rolls off one of VistaPrint's $5 million-plus presses. The company's software pulls together batches of similar jobs the presses can handle most efficiently in one run. That's why postcards from different customers might end up on one sheet of paper. And by cutting orders jigsaw fashion, there's little waste. Local print shops, and even FedEx Kinko's, can't match that efficiency since they address each job separately. Of course, with VistaPrint, shipping costs must be factored in. (Delivery usually takes about a week.)

HARDER THAN IT LOOKS

VISTAPRINT'S ONLINE tools help clinch the deal. Clients design business cards and brochures from scratch or use templates at VistaPrint's site. Because the programs are easy to use, almost 90% of orders are uploaded by customers and done online. David Boris, co-founder of men's-lifestyle site BeBetterguys.com, says the low prices and easy ordering prompted him to use direct-mail postcards to supplement online marketing.

These innovations have made VistaPrint one of the best-performing initial public offerings. Shares of the Bermuda-based company, whose operations are run from Lexington, Mass., have zoomed 125% since the IPO last September. Analysts expect revenues this calendar year to rise 66% above 2005's $117 million.

If there's a threat to VistaPrint, it's potential competition from giants like Staples Inc. or FedEx Kinko's. The company's patents will slow down foes, but the best barrier to entry is the complexity of VistaPrint's technology. Rivals are trying to catch up, but VistaPrint established a lead when competing services, such as a partnership of iPrint.com Inc. and Kinko's, failed to gain traction during the Web boom.

Still, Keane may join forces with players rather than fight them. The company says nothing is imminent. But Abigail Mullen at Highland Capital Partners, a VistaPrint investor and director, hints that VistaPrint will sign a partner so it can sell through in-store kiosks.

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Urban Outfitters, Fashion Victim

The chain misjudged customers' tastes. Can it recalibrate its edginess detector?

BY JESSI HEMPEL

HEATHER FAULAND IS your typical Urban Outfitters shopper. Usually clad in jeans and a witty T-shirt, the 21-year-old Tucson college student turns to Urban for the fashion flair that sets her apart from Gap-ified mainstream teens: a flowing skirt, a blue-and-green striped wallet, and, in reference to the month she spent as a vegan in high school, a red tee with a pig that says: "Please Don't Eat Me, I Love You." But since Christmas, she says, Urban has gone from reliably edgy to simply outré. When passing by the Urban Outfitters near the University of Arizona's Tucson campus, she sniffs at the mannequins sporting tight leggings, a tank top worn over a button-down shirt over a sweater with odd cuts and capped sleeves. "I just don't seem to like their kind of edgy right now," says Fauland. "It looks kind of funny."

GREENWICH VILLAGE Styles were hits in the spring cata are arriving in stores

In the language of hipster retailing, that is a devastating critique. Urban Outfitters' success lies in its ability to pinpoint exactly what kind of edge its hip—but not too hip—customers want. And judging by the past few months, the chain badly misjudged its shoppers' sensibilities. Last fall, in its 95 stores worldwide, Urban's buyers proved too quick to embrace new styles. The fashion avant-garde may have been willing to part with distressed jeans and peasant shirts in favor of '80s-style peg-legged pants and baggy V-shaped tops, but Urban's customers balked. (Executives declined comment for this story.)

THE STAT

26%

Urban Outfitters' first-quarter earnings drop

Seismic shifts in fashion come around maybe twice a decade, and most retailers err by not keeping up. Urban Outfitters was too aggressive, and now its fashion faux pas is starting to hurt the bottom line. Net income had climbed an average annual 44% since 2003, hitting $131 million last year on sales of $1.1 billion. But inventory started to pile up. Philadelphia-based Urban Outfitters Inc., which boasted net margins of nearly 12% last year, was forced to mark down merchandise. As a result, first-quarter earnings plunged 26%. The chain's stock recently skidded to 15.95, a 52-week

Compounding Urban's woes w miscalculation at another of its ap chains, Anthropologie Inc. Anthro gie's 81 stores target women age 30 and account for 36% of the compa sales. Last September, Anthro's French countryside interiors were p tuated by goth clothes leaning towar theatrical: high necks, dark colors, oversize buttons. When consumers d bite, Anthropologie rapidly reto stocking October shelves with sta such as basic pants and long-sleeve shirts. But by that time consumers what they needed for the season.

Urban acted fast this spring to away excess inventory while simult ously testing new design catalogs. Styles that took of already making their way stores, and the clearance ar Urban's Greenwich Village post in Manhattan is no lo overflowing with goods. some analysts remain cerned that Urban has g too big for its stylish brit Executives have said they move ahead with plans to as many as 38 new stores Urban Outfitters, Anthrop gie, and Free People, Urb discount concept, which ha locations. JPMorgan Chas Co. analyst Brian Morgan gested in a recent report strong sales in recent years have masked deeper inven problems and that the re doesn't have the agility to move quick scale back inventory.

It all comes back to the vagarie fashion. In retail "it is hard to be on top of the heap for a long period of ti says Mary Brett Whitfield, a senior president at research firm Retail Forv Inc. in Columbus, Ohio. "What's hot moment can easily be not [the ne The back-to-school season, which s in late July, will be a critical test for Ur The company will need to make sm bets about style, helping its shoppers one step ahead of their peers without ing too far. In other words, be in fash but don't be ahead of fashion. Be di ent, but don't be too different. Soun lot like high school. ■

–With Danna Cook in New

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CURTIS Trend-spotting in Milan, Rio, and other fashion centers

Staying Cool At Nokia

How new design chief Alastair Curtis keeps the hot handsets coming

BY JACK EWING

ALASTAIR CURTIS, Nokia Corp.'s design chief, loves to say that his job "is much more than just style." To see what he means, slide open the cover of Nokia's ultra-stylish 8800 cell phone, and you'll hear a satisfying "thunk" that suggests the workings of a luxury car. That's no accident. Nokia designers and engineers spent months tinkering with the springs and bearings in the cover of the $650 phone. "You can't put it into a technical term. It just feels good," Curtis says, flicking open an 8800 with a practiced motion. Another touch: Nokia hired avant-garde musician Ryuichi Sakamoto to compose ring tones exclusively for the 8800 series. "Design," Curtis says in Nokia's airy headquarters on a cove outside Helsinki, "is the look and the identity of the product, but also the usability, the packaging, the interface, even the retail experience."

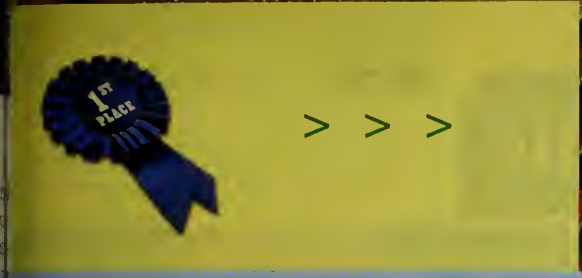
That sort thinking hel Curtis bec Nokia's top de executive in A The 38-year-old Brit has a reputatio pulling together technology and aest ics into a package that sells, and play big role in top sellers such as the folding "clamshell" phone and the r priced 6230. The 8800, meanwhile, been a hit from Miami to Moscow, more than a million sold since its in duction in mid-2005.

LATE TO THE PARTY

CURTIS' NEW job is tough. As han makers pack in ever more electronic gets harder and harder to create phc that are both beautiful and functio True, Nokia already supplies a third of world's mobile phones, selling 75 mil handsets just in the first quarter of 20 But it lost its edge a couple of years b when it was late to recognize the shi clamshells, and competition today fiercer than ever. Motorola Inc., with RAZR and PEBL lines, and LG Electro Inc., with its dark, rectangular "choco phone," have raised the industry cool quotient. The big risk: Nokia could back into making phones that are cautious and dull. Nokia makes "ex lently designed phones such as 8800," says Cha Kang Heui, LG E tronics' chief handset designer. " some other phones are lackluster."

To ward off the generic and bor Curtis has teams of scouts tramp through Milan, Rio de Janeiro, and ot centers of fashion and youth cult They speak to architects, furniture signers, paint specialists, plastics e neers, and students. "By observing p ple, you see the way they interact, the they do things, the strange rituals t have," says Curtis, who makes a poin visiting public spaces such as parks to how people use their phones. One sight: People tend to share photos by s ply passing the handset to a friend. Nokia built some of its newest N se models with screens that fold out and ot for easier sharing.

The intelligence-gathering has led to products such as the L'Amour lection, aimed at the most fashion-c scious consumers. The look is based an Art Deco-influenced "shabby ch and the phones feature metallic fa etched with dreamy patterns, and r plastic bodies with the look and fee Chinese porcelain. But the research is just about fashion. Watching busine



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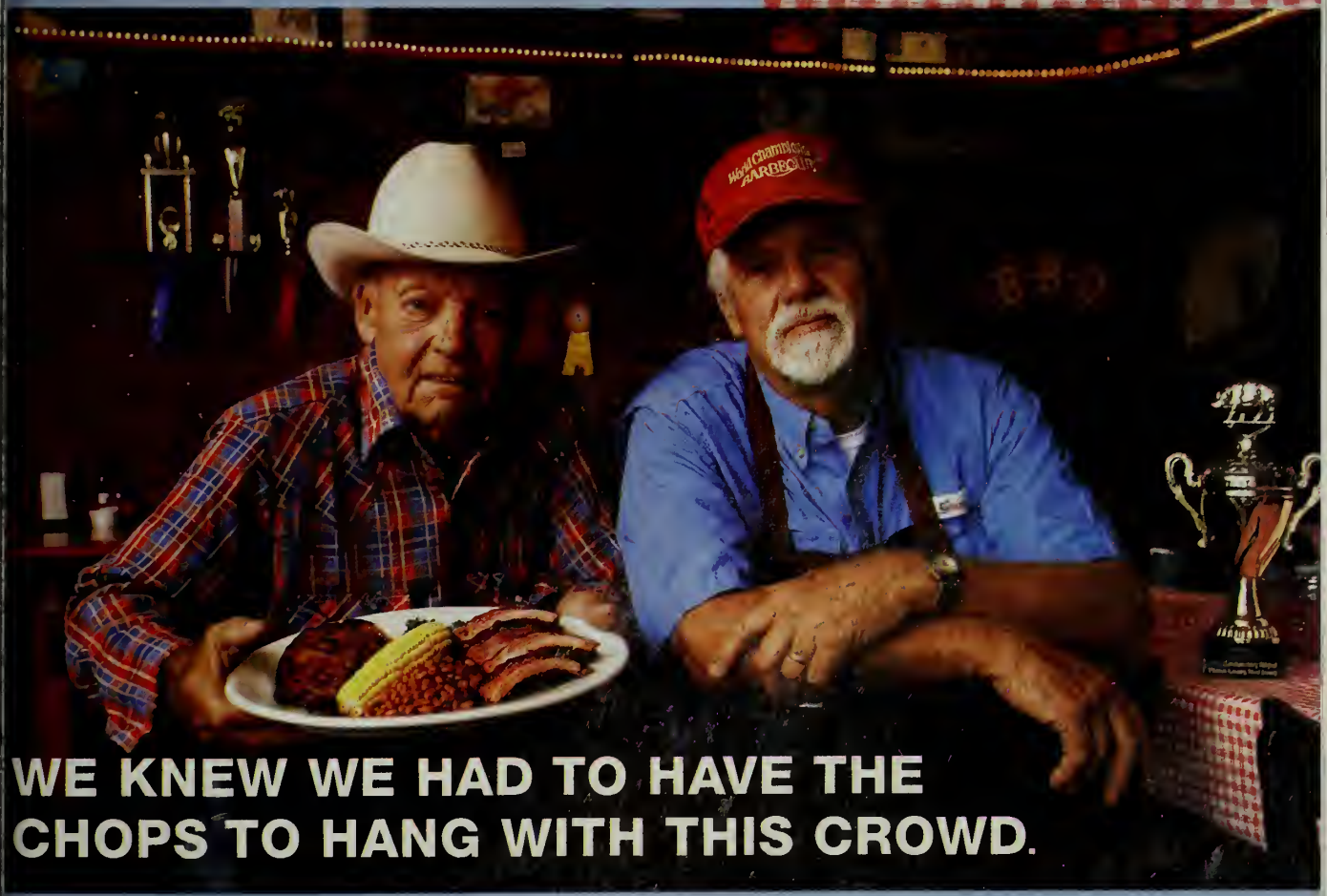
Some folks barbeque for fun. Others do it for a living. Something they all share are tough standards for the ribs, pork shoulders and boneless loins they use. Cargill learned from chefs and grocers that people want more flavorful pork that cooks up tender and juicy. We developed it using special feeds, growing processes and selection techniques. Barbeque enthusiasts say they like the new pork. What they won't tell us are their secrets for cooking it. This is how Cargill works with customers.

collaborate > create > succeed



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nnovation

ple led Nokia to equip its new E61 ıdset with a button that takes users ight to e-mail.

Curtis, a graduate of London's Royal lege of Art, jets constantly between dia design centers in Helsinki, Lon-ı, Los Angeles, and Beijing. But he er loses touch with top managers or :s executives. "In addition to being a igner, he thinks and speaks in busi-s terms," says Nokia CEO Olli-Pekka lasvuo. Dreaming is also part of the , which Curtis sometimes does while for lengthy rides on his racing bike. ıu think five years out, six years out, l then you come back in. You create ɔping stones to the future," he says.

So where do those steps lead? Nokia's ıd oracles say customers will want to be nected all the time, seeing their hand-s as entertainment centers and as a way

okia's N93 plays usic, shoots video, urfs the et, and as a fold-ut screen

hare their lives with friends and family. e are moving away from phones as ls to phones as companions," says Elise anto, Nokia's "senior consumer vision nager." The N93, due out later this year, ys music, shoots high-quality video, fs the Net, and has a fold-out 2.4-inch een for watching TV. Further away are nes that will capture an image of an ect, and then search the Net for more rmation about it. Point the handset at a s to get the schedule, for example, or ı your phone at a restaurant to read a iew. Says Curtis: "What you see today is hing compared to what you're going to ." Nokia is counting on him to see it be-e anyone else.

–With Moon Ihlwan in Seoul

BusinessWeek online For a slide show of the st Nokia phones and a Q&A with Curtis, to www.businessweek.com

PLANNED DESTRUCTION OF THE SALLE PLEYEL CONCERT HALL IN PARIS

NOW IS THE TIME TO REACT!

We appeal to the International Community to save the Salle Pleyel concert hall in Paris!

French authorities have given the order to destroy Salle Pleyel. Professional musicians and music lovers are outraged.

Immediate action must be taken!

This unique Art Deco building, which was built in 1927, with a seating capacity of 3000, was lauded by architect Le Corbusier for its revolutionary "ideal" acoustics. It has hosted all of the great names in the music world. **Paris is on the verge of destroying Salle Pleyel ... meanwhile, New York continues to vigorously protect Carnegie Hall, Vienna its Musikverein and Amsterdam its Konzertgebouw !**
The international music community recognizes the importance of preserving quality institutions. Paris does not.

It is time to take action!

A large media campaign has announced that plans are underway to renovate Salle Pleyel: **This is a lie!**
The walls, the proscenium arch, and the marvelous acoustics are being torn down, to make way for a small, multipurpose space with 600 fewer seats; and two rooms are being eliminated entirely: the 480–seat Salle Chopin and the 150–seat Salle Debussy.

If the Salle Pleyel is ultimately destroyed, Paris will be left without a world–class concert hall.

Pleyel friends, we must join forces and ACT NOW! Sign up to speak out!

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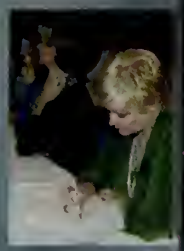
The NBTA Convention Guide to Corporate Travel

At most global organizations, travel management plays a significant financial role. Since travel is typically a corporation's second or third largest controllable expense, having experienced travel management professionals manage travel-related services provides measurable benefits. Monitoring and analyzing travel expenditures is essential for realizing cost control.

But savings is only one of many responsibilities that travel managers are charged with. Others include safety and security, sourcing and procurement, technology tools, and business strategy and negotiation. These topics and more will be discussed in 50 sessions at the National Business Travel Association's 38th Annual International Convention & Exposition, which brings more than 5,000 buyers and suppliers together for seminars, workshops and product showcases. Keynote speakers will include former CEO & president of Hewlett-Packard Carly Fiorino, former CNN anchor Bernard Shaw and President George H. W. Bush.



TOPICS on the CONFERENCE AGENDA:

The Persistent Challenges of Globalization

One of the key tenets of best-practice travel purchasing is consolidation. In theory, that means using one global travel agency, one self-booking platform, and one T&E charge card throughout the enterprise; it also means negotiating world-wide airline, hotel and ground

Softer flat beds for
a deeper sleep.
he best service anticipates your needs. To give you the best possible sleep, we used the latest in cushioning
chnology to create an even more comfortable flat bed. And to add to your comfort, we include plumper pillows and cozier
lankets. Our goal is simple: to deliver the best service you could ask for, without you having to ask. So whether you're
njoying a gourmet meal, or an Arrivals Lounge that feels more like a spa, we think you'll find our business class like no other.
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transportation agreements. The result would be better cost control through improved visibility, increased purchasing power, and streamlined administration, by using fewer vendors and by standardizing purchasing processes.

In practice, however, global consolidation is far trickier than it may seem. The obstacles range from technical (platforms that don't integrate seamlessly) to linguistic (providing multiple versions of self-booking and expense management tools that must

be created). There are also human and cultural factors—resistance to change, a preference for local vendors and a desire to remain autonomous.

It takes time, patience, a careful change management program, and above all, a champion at the C-level to move globalization forward. Many companies launch globalization efforts one market at a time using a local procurement professional to push the effort forward, to oversee communications with travelers, IT integration, and training.

Is Dynamic Pricing Driving Up Travel Costs

Travelers know all about dynamic pricing—they're painfully aware that airline seats cost more or less depending on how full a flight is, how far in advance a flight is booked, and how much competition there is on the route. Now hotel companies are hoping to use that pricing model when determining room rates, and travel managers are weighing the potential impact. "It means tough challenges when it comes time for finalizing budgets and negotiating rates for a corporate hotel program," according to Sam Schisler, global hotel program manager for Limited Brands and incoming chairman of the National Business Travel Association's hotel committee.

Up until now, says Schisler, corporations were able to lock in fixed, negotiated prices for hotel rooms in an annual contract. Agreements, either on a chain-wide level or with individual properties, directed travelers to book those chains or properties in exchange for discounts and preferential treatment, like space-available upgrades. That's why moving to fluctuating market rates in a market with steeply rising rates means that hotel spend is likely to jump, and continue to move up in 2006 and 2007. According to PricewaterhouseCoopers, the average daily hotel-room rate has increased more than five percent a year for the past three years.

Many travel managers, Shisler says, are working hard with their hotel partners to maintain the traditional model. Meantime, some hotel companies are working closely with travel managers on a middle ground between a market rate and a fixed negotiated rate. Marriott, for example, offers some companies a floating discount off a benchmark rate.

Keeping Meetings Costs Under Control

Corporate America spends upwards of $100 billion a year on meetings according to industry experts, totaling between one-third and two-thirds of their total corporate-travel budgets. That's why companies are taking a careful look at the way meetings are called, planned and paid for, says Kari Knoll Kesler, global manager for Honeywell Meeting Solutions and chair of NBTA's Groups & Meetings Committee.

Companies are also taking a much mo strategic view of group spend. Kesler, wh has a background in procurement, says th best practices in strategic meetings man agement include using a single payme platform, such as a corporate meeting card for all meetings and events, establis ing a clear meetings policy, using specifi processes for site selection, registration, payment, contract management, etc., an combining group with transient spend.

The Ultimate Comfort and Convenience in the Air

Long-haul flights can be tough on body and soul, but **British Airways** has designed a way for business passengers to comfortably sleep, work and relax a 35,000 feet.

More than $350 million was spent on the new Club World. The seats are designed in forward and rearward facing pairs. When upright, the seats feel like armchairs, and convert to a six-foot, fully flat bed at the touch of a button. The lounge-style layout is designed to maximize personal space and privacy, with each seat also featuring individual privacy screens. Passengers are treated to large pillows and cushy blankets to help them sleep even better. And when they're awake, they're treated to menu recently re-designed by the airline's 'culinary council' of celebrity chefs.

Superb inflight service is just one of the reasons why British Airways just won the 2006 Airline of the Year award by Skytrax. For more information on Club World, visit **www.britishairways.com**.

NBTA Resources Help Companies Make the Most of Travel Programs

NBTA Chicago/06 International Convention & Exposition

Through effective travel management, businesses meet strategic business goals, maximize the value of travel expenditures, and minimize risk for traveling employees. To ensure your company is using best practices and staying current on the latest developments in travel management, take advantage of the networking and professional development opportunities offered by the National Business Travel Association.

The 2007 NBTA International Convention & Exposition will be held in Boston, July 22-27. NBTA also offers opportunities for education and networking year-round, including events in financial centers such Brazil and London, web-based seminars and the industry's only professional certification. Members also get access to resources to keep them informed and help them do their jobs better, including a daily news update, original research, white papers and sample RFPs.

For more information on the resources offered by NBTA, see **www.nbta.org**

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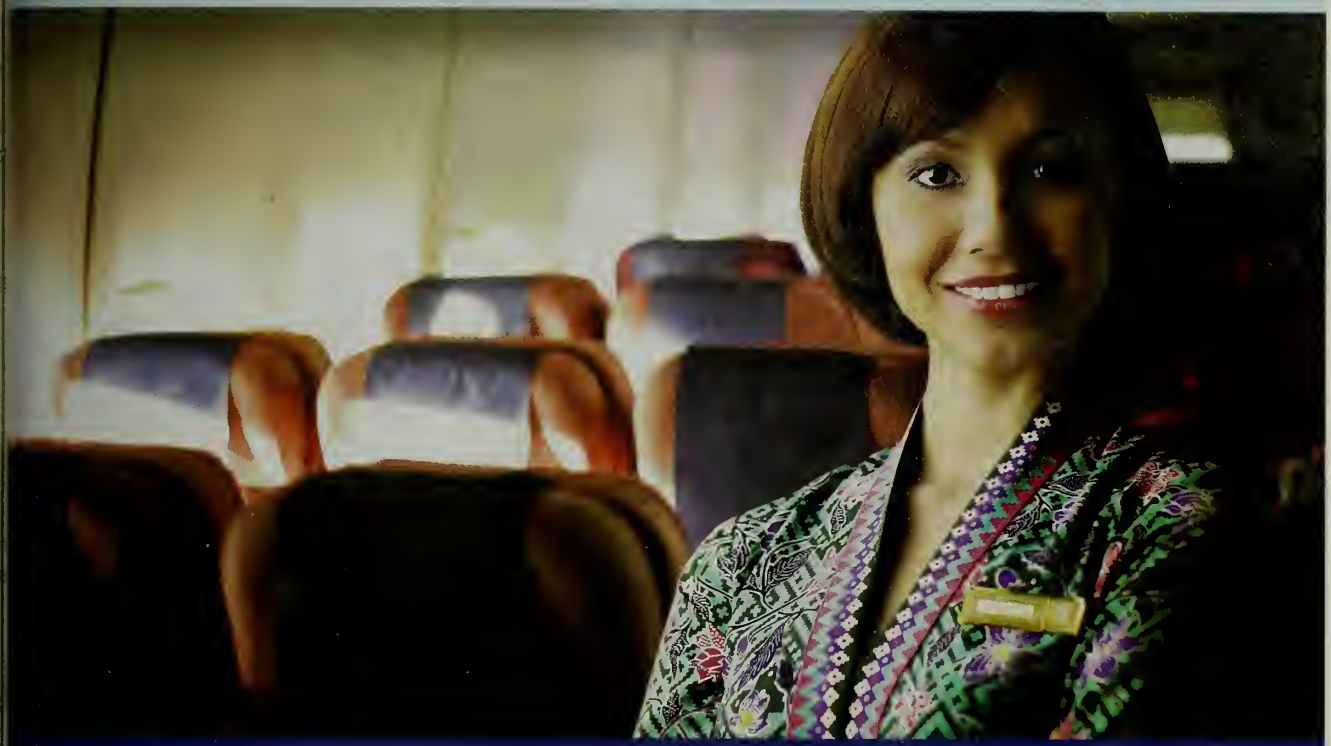

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doing so, companies not only increase their purchasing power but drive efficiency in the pre-program (planning) and post-program (tracking and reconciling) phases.

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Automation has swept the travel management space; most corporations use online bookings to save on the front end, and they're looking to automate the back end as well—to streamline processing, gain visibility over spending patterns, and increase control. By moving from a largely manual process to a system that feeds corporate card charges directly into an electronic template, companies are yielding all sorts of benefits for travelers, their managers, and the back office.

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The advantage of Gelco's solution is just speed, but cost-effectiveness. "A ma ual expense report typically costs $20-$ with Gelco, the price is less than $10 t file, route, pay, and audit," said Troy Thibodeau, vice president of marketing

for Gelco Expense Management. For a company that processes 100,000 report year, the savings can easily reach seven figures per year. "There aren't many processes that can demonstrate this big impact so quickly with so little disruptio said Thibodeau. "It's not expensive, no difficult to implement, and it's extreme popular with users." For more informati visit: **www.gelco.com.**

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Malaysia Airlines' first- and business-class passengers are pampered in-flight, with five star, award-winning service and world-class amenities. The pampering continues on the ground with Malaysia Airlines' award-winning Golden Lounges at key destinations around the world.

The Golden Lounge at Kuala Lumpur International Airport, Malaysia Airlines' hub, is the most spectacular of all. Arriving, departing and transit premium passengers are treated to spa facilities, including showers, a sauna, salon and mini-gym; a cyber café/bistro; and a Relaxation Room featuring innovative massage chairs and foot massagers. The business center provides a meeting room that accommodates eight people, complimentary business services (fax, photocopy and local phone calls), both wired and wireless Internet broadband as well as dial-up connections, and a selection of peripherals for guest use (including adaptors, printers, transformers, mouse, etc.).

No wonder the Golden Lounges have won prestigious international awards from Skytrax and Inflight Research Services. For more information on Malaysia Airlines and the Golden Lounges, please visit **www.malaysiaairlinesusa.com**.

Writer: Julie Moline is a business travel specia and a frequent contributor to various consum trade and in-flight publications.

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E-mail: jon@meigsmedia.com
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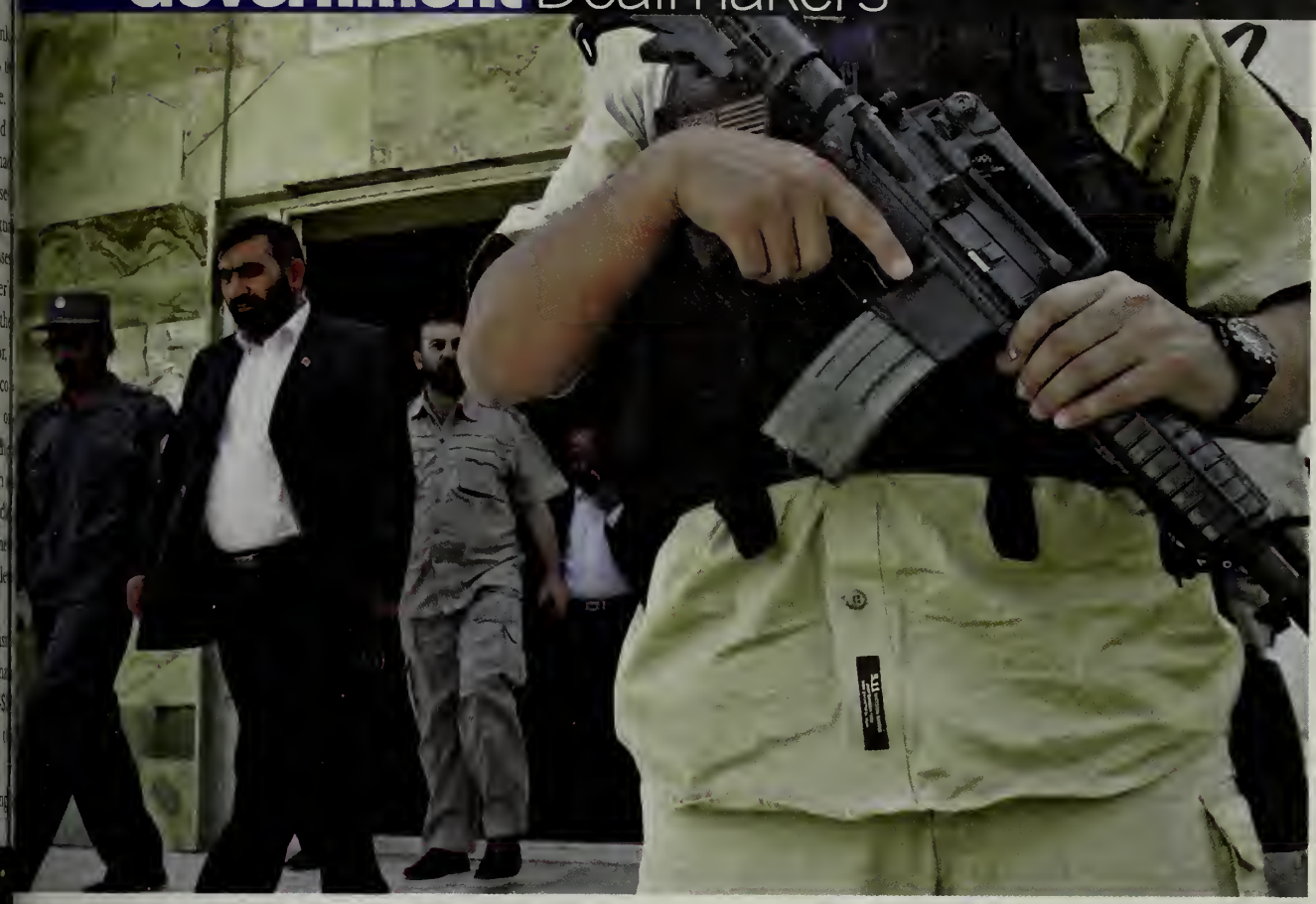

SECURITY A DynCorp employee guards a provincial governor in Afghanistan

Tainted Past? No Problem

rivate-equity fund Veritas thrives by urning around sullied defense contractors

EAMON JAVERS AND WN KOPECKI

HOW'S THIS FOR AN investment opportunity? For sale: one defense contractor, linked to congressional bribery scandal, owner possibly facing prison time.

That's Bob McKeon's kind of deal. Keon is the founder of Veritas Capital, lew York private-equity firm that in- ts in intelligence and defense contrac- s. Among the fund's holdings: Dyn- p International Inc. in Irving, Tex., whose name was tarnished in the late 1990s when some of its employees in Bosnia became embroiled in a sex trafficking scandal.

In the summer of 2005, another scandal-plagued military contractor caught McKeon's eye. MZM Inc. was the focus of a federal investigation into whether its owner bribed California Representative Randy "Duke" Cunningham in exchange for hundreds of millions of dollars of government contracts providing technical and other support to intelligence agencies and the military. Sensing an opportunity, McKeon hired a former CIA general counsel to quiz Pentagon and intelligence officials about the viability of MZM's business, which before the invasion of Iraq included helping with controversial analysis of Saddam Hussein's nuclear capabilities. "We take on messy situations, and MZM was a mess," says McKeon, whose top secret security clearance still doesn't allow him to know all the details of what his companies do.

He closed the MZM deal in September for around $20 million and renamed the company Athena Innovative Solutions, after the Greek goddess of wisdom and war. Athena has projected revenues this year of more than $100 million. The company is "clean, it's got a different name, it's got new leadership, and it's doing very important work for the country," McKeon says.

Not everyone is cheering. Critics argue that Athena's apparent success rests on lucrative contracts landed under questionable circumstances. "Veritas is profiting from the spoils of congressional bribes," says Keith Ashdown, vice-president of Taxpayers for Common Sense, in Washington.

McKeon, 51, shrugs off that kind of criticism and continues to expand his firm, tapping into a market that since the Sep-

Government Dealmakers

tember 11 attacks has seen a spike in private investment. According to Thomson Financial and the National Venture Capital Assn., private-equity firms have invested in 628 defense and homeland security companies, many of them relatively small. Veritas is poised to become a major player, helping to fill a void left by the Carlyle Group, a much larger private-equity firm that has moved away from its military industry roots to take on a wider range of deals, says John Hagan, managing director at BB&T Capital Markets/Windsor Group, an investment banking arm that specializes in defense and aerospace.

Robert B. McKeon founded Veritas in 1992 with Thomas J. Campbell, 47, a fellow former investment banker from Wasserstein Perella Management Partners Inc., where McKeon was president, then chairman, from 1988 to 1992. Veritas has three funds, ranging from $175 million to more than $600 million.

NO REFUND

THE BRONX-BORN McKeon, a Harvard B-school grad, has a reputation as a hard-nosed businessman. In 1999 a consultant for Veritas admitted he had paid kickbacks to the Connecticut treasurer, who had approved the state's $125 million investment in a Veritas fund. Connecticut officials demanded a refund, but McKeon refused, arguing that no employee of the firm knew about the contractor's actions or had done anything wrong. Connecticut kept its money in the fund and realized a return of nearly 24%, according to state documents. (The treasurer pleaded guilty in the kickback scheme; no one connected to Veritas, including the consultant, was criminally charged.)

Today, McKeon, a history and military buff, oversees a firm that owns all or part of seven companies, including Wornick Co., which sells food rations to the military, and McNeil Technologies Inc., a defense and intelligence contractor.

TOP SECRET Not even McKeon is privy to all the details of his companies' work

DynCorp is Veritas's best-known and potentially most lucrative holding. Veritas paid $850 million for the company in 2005, putting down $100 million of its own cash and borrowing the rest. Veritas took DynCorp public in May, and the company is now valued at about $1.4 billion. (Veritas retains a 56% stake in DynCorp but is prevented from selling its shares until this fall.)

DynCorp has more than 14,000 employees and generates nearly $2 billion in annual revenue from its work for the government. About half involves air maintenance; the rest is more exotic ing helicopter gunships on Colom coca-eradication missions, training p in Iraq, and providing security Afghanistan. McKeon remains chair of DynCorp, a job unlike most boardr posts. When he traveled to Afghanista June, DynCorp security men rode in v cles on either side of the one transpor McKeon, protecting him from parked that could have hidden a bomb.

McKeon's most recent acquisition tainted by controversy even before re tions about the congressional bri scandal. Public records show that ployees of Athena's predecessor, M worked at the National Ground Int gence Center in Charlottesville, Va., a Army office that analyzed foreign r taries. The center, although not MZM particular, was heavily criticized by P ident George W. Bush's commissio weapons of mass destruction for characterizing Saddam Hussein's nuc capabilities during the runup to the war. MZM also worked with the Nati Security Agency, the FBI, and the CIA

GAMBLING ON A TRANSFER

MCKEON MINIMIZED his risk in chasing MZM by insisting that wouldn't pay then-owner and Mitchell J. Wade full price if McKeon n't able to keep MZM's dozen or so tracts. Wade, who has pled guilty to ing the disgraced Cunningham, is no only one linked to the company who been implicated in illegal activity. On 30, federal prosecutors accused for MZM employee Richard A. Berglund, tired military officer, of helping Wade nel improper campaign contributi McKeon says Berglund left the comp earlier this year after it became awa his potential legal trouble.

McKeon had no guarantees that Pe gon officials would approve the tran of MZM's contracts to Athena, a deci that would be made only after mandatory Defense Dept. review gered when a contractor is sold. The mer CIA general counsel he hired, Jef H. Smith, now a partner at the Wash ton law firm Arnold & Porter, repo back that the half-dozen intellig agencies he approached thought high MZM. McKeon's gamble paid off w the Pentagon approved Athena's take of all of MZM's contracts.

Asked what Athena's employees d day, McKeon says: "That's classified" declines to elaborate.

Guilty Pleas
...But lucrative contracts

MITCHELL J. WADE: The founder and former chairman of MZM, the intelligence and defense contractor acquired by Veritas Capital; he admitted funneling money and valuables totaling at least $1.5 million to Randy "Duke" Cunningham, then a member of Congress, in exchange for help obtaining federal contracts.

RANDY "DUKE" CUNNINGHAM: The former California Republican and naval aviator is serving an eight-year, four-month prison term after admitting he received cash, real estate, silver candelabras, Persian rugs, and other luxuries for aiding MZM.

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Ohio assisted VALiD's development with a $1.1 million Technology Action Fund Grant, part of a comprehensive state funding plan that shares the risk in launching new products. In fact, Ohio is an ideal location for innovative technology companies like AlphaMicron, with an impressive balance of profitable business advantages combined with an uncompromising personal lifestyle. While Ohio is a center for leading-edge technology, research and development, with excellent transportation and a skilled workforce, its diverse culture, outstanding schools and affordable housing make it an attractive place to live, too.

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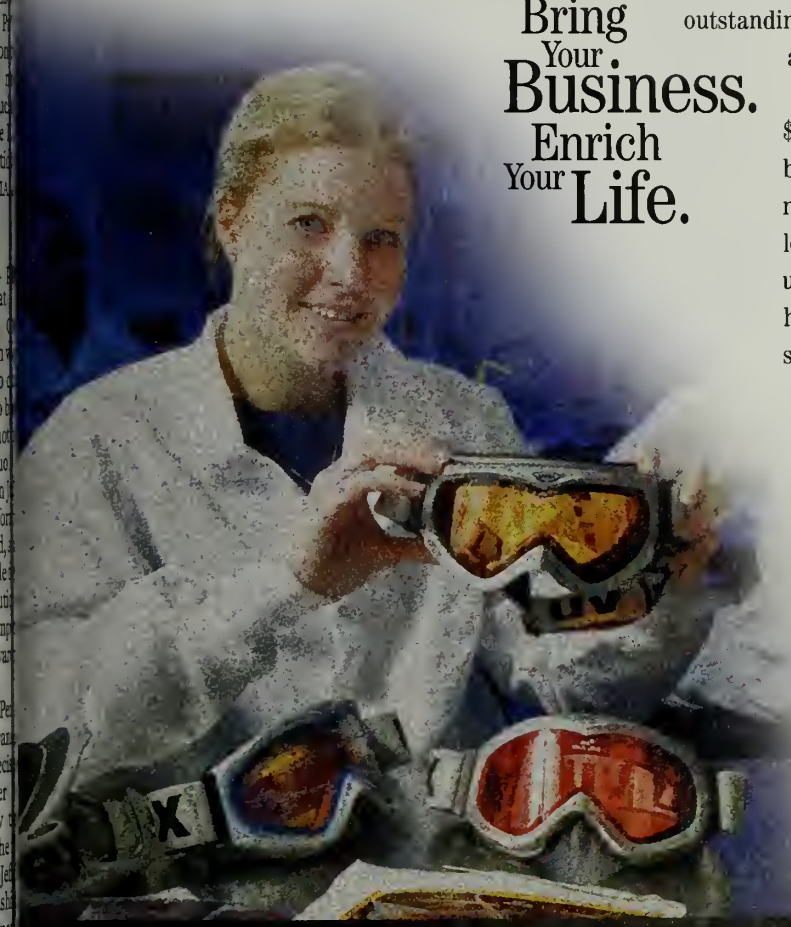

"We brought our light controlling technology to market much more quickly with help from Ohio. That made the venture profitable more quickly as well."

— Bahman Taheri, Ph.D, CEO, AlphaMicron, Inc.

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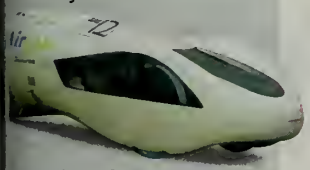
ITED BY
LENE WEINTRAUB

NNOVATIONS

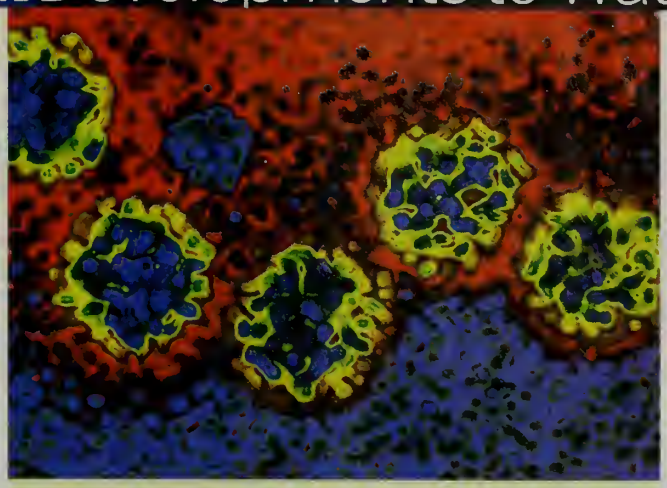
f self-fertilization nd super MPG

In a step that could duce the use of energy- ensive, man-made tilizers, plant scientists are lping crops form their own nuscule fertilizer factories. nature, legumes such as as and beans have the ility to convert nitrogen m the soil into a growth omoter. When their roots e exposed to soil bacteria own as *rhizobia*, the root lls grow nodules, which come home to a second d of soil bacteria that can ocess nitrogen for the ant. Now geneticists in itain and Denmark have dled with legume genes to t them to form root nodules thout any help from *zobia*. If the responsible ne can be swapped into eat and rice, cereal crops y someday be able to eate a welcoming home for tilizer-making bugs.

Boston to Seattle for $3, t including food and dging? That's what a cross- untry trek would cost if u drove the winner of last nth's Supermileage race Marshall, Mich., onsored by the Society of tomotive Engineers. ilt by students at the iversity of British



lumbia in Canada, this ar's winner can go 3,134 les on one gallon of gas. re go-cart than V, the three-wheeler relies ultralight materials, ulpted aerodynamics, d a 54cc engine to max t mileage. *–Adam Aston*



BIOTECH

SAVING SOME HEP C PATIENTS THE PAIN OF TREATMENT

AS ANY PATIENT with hepatitis C can attest, the standard treatment often feels more dreadful than the virus itself. The drug, called interferon, causes severe flu-like symptoms. What's more, "it's very expensive, and it only works 50% of the time," says Kathy Ordoñez, president of Celera Genomics, in Rockville, Md. Now scientists at the company, which is famous for mapping the human genome, are offering a way for doctors to determine which patients would benefit most from the drug.

Comparing the genomes of patients who developed progressive liver disease with those of patients who did not, Celera identified a set of genetic markers. This resulted in a test that reveals how likely a patient with hep C will be to develop cirrhosis, which can lead to liver cancer. Called the Cirrhosis Risk Score, the test could save the health-care system $28 million each year by letting physicians avoid liver biopsies. Targeting treatments to the highest-risk patients could add to those savings, Celera says.

WIRELESS

RAISING THE CELL PHONE SPEED LIMIT

THERE ARE PLENTY of fun things people might do on their cell phones if network speeds were a faster. Kids, in particular, would probably be watching more video clips, downloading more songs, and spending more time updating their pages on MySpace. Phones that can take advantage of Wi-Fi already cater to this market, but you have to muck around with access codes and other complications.

Tiny Azaire Networks says it has a device cellular operators could use to make this process a lot simpler. Once the device is installed on the network, cell phones would automatically sense that they were in a Wi-Fi hotspot and switch the handset from cellular frequency to much faster Wi-Fi speeds. The next step is persuading U.S. network operators to sign on. Azaire already has deals with carriers in Europe, Asia, and Australia, but so far, the U.S. is a harder sell.

–Neil Gross

MONITORS

A WATCH THAT KEEPS WATCH ON THE ELDERLY

A NEW WRISTWATCH targeted at the elderly does more than tell time. The device, from tech startup Exmovere, uses an infrared laser to measure heart rate and other vital signs. The watch also extracts clues about the wearer's emotional state based on pulse rate, sweat levels, movement patterns, and other physiological signs. Using wireless and location-based technologies (Bluetooth and global

positioning systems), the watch automatically syncs with a nearby PC, a cell phone, or an optional pocket PC for use while driving, which then sends e-mail or text message updates to family members on the device that they choose.

"We wanted to automate caregiving for busy people," said David Bychkov, a retired professor of psycho-physiology and president of Exmovere. He fine-tuned the watch with the help of 400 elderly product testers. Exmovere recently launched a mass-market version, starting at $1,193 for six months of service. The company will launch a more upscale model within two months as well as a watch for soldiers on active duty.

–Aili McConnon

SATISFIED CUSTOMER Moon likes Gmarket's prices and search function

Out-eBaying eBay In Korea

The giant's most successful Asian business is under attack from Gmarket

BY MOON IHLWAN AND ROB HOF

EBAY INC. IS A $4.6 BILLION global powerhouse in Internet commerce, but it has struggled recently in Asia. Now it faces a dogfight in South Korea, its strongest Asian market, with an upstart that offers an intriguing mix of cheaper listings, fixed prices, and a Web site that explodes with flashing product come-ons. And to top it off, the outfit—Gmarket Inc.—has a pocketful of cash following a 9% ownership stake taken by Yahoo! Inc. and a recent IPO.

Just two years ago, eBay's subsidiary, Internet Auction Co., was the dominant player in Korea. It accounted for 75% of eBay's Asian revenues, industry officials say. But less than three years after Gmarket got into the business, it has caught up. In the first quarter of 2006, Gmarket and Internet Auction both sold about $490 million worth of goods, says one industry insider. EBay won't confirm that. Gmarket saw its first-quarter net revenues from commissions and advertising triple from last year, to $29.6 million. "Its stunning growth has made Gmarket neck-and-neck with Internet Auction," says Lee Hyun Chang, director at Seoul-based market researcher Metrix.

What's the appeal of Gmarket? For one thing, it places less emphasis on an open-auction format than eBay does. The company offers goods at fixed prices, with an option to negotiate with a seller on an exclusive basis. This allows buyers to conclude deals instantly instead of making them wait until all bids are completed in open auctions. The opti available on eBay in Korea, but Gma is further along, with 90% of its sales ume using that method. The formul tracts enthusiastic buyers such as Mo Won, a 26-year-old Seoul office wo Says Moon: "I feel I have the best de Gmarket. It offers great prices and a cellent search function."

FEROCIOUS RIVALRY

MERCHANTS SAY it's cheaper to items at Gmarket than at Internet tion. Gmarket also has introduced keting initiatives to differentiate it The goal is to constantly provide features while injecting fun into sh ping. One such program is a lo called "lucky auction." It gives shop chances to buy everything from LCI evisions to T-shirts at a small fractic the market value. Gmarket's comp picks the winner at random.

In the U.S., Yahoo and eBay forged a broad-ranging advertising online-payments alliance. But in their rivalry is ferocious. Yahoo's Ja subsidiary crushed eBay in the profit e-commerce market, the regi biggest, earlier this decade. Yahoo has a 40% interest in Alibaba.com C eBay's chief rival in China. And on 6, Yahoo purchased a 10% stak Gmarket for some $60 million from Investment Partners, a U.S. venture ital firm.

Gmarket raised $92.7 million in June 29 NASDAQ public offering. plus help from Yahoo—whose stake reduced slightly, to 9%, by the IPO—help Gmarket push into other mar including at least one other Asian c try next year. "The NASDAQ lis instead of an IPO in Korea, under our determination to grow in inte tional markets," says Jo Chang Gmarket senior vice-president of ness development.

To better compete, eBay recently i duced a fashion-orie Korean site called " Sancy" that it hopes appeal to younger fe shoppers. It upped placement of its lis in shopping-compa sites, allowed them posted on personal b and cut its own com sions on sellers. Mat J. Bannick, presider eBay International, analysts in May: "V on the right path."

THE STAT

$92.7 million

Amount raised by Gmarket in its June 29 public stock offering on the NASDAQ

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Implementation times are dependent upon a number of factors and may vary significantly. Referenced customer implementation times were from initial software installation to project go-live with real business data, and the implementations were for unmodified software.

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Almost Too Pretty To Shoot

Purdey's bespoke shotguns are handcrafted, the old-fashioned way. **BY STANLEY REED**

THE CLAY PIG whirls over a g field groomed to ulate a grouse r Braced against right shoulder, Purdey 12-bore gun follows the black saucer e and then, with a barely perceptible on the trigger, blasts it to bits.

I was at the West London Sho School near Heathrow Airport, tryin two guns from James Purdey & Purdey is one of the few London makers that still make sporting wea the way they did in the 19th century. a novice like myself can appreciat fine balance of the guns, the crisp they eject spent shells, and their ele antique looks.

Many gun fanciers consider Pu the tops (purdey.com). "They are school stuff; they are beautifully m says Nicholas Holt, who owns Hol London gun auctioneer, and looks the Queen's gun collection. Other l end British gunmakers include Bo Co. and Holland & Holland.

The original James Purdey set up on Princes Street just off Leic Square in 1816. The company quickl came gunmaker of choice for gentry royalty. Purdey was at the fore of changes in gun technology in the century, then time came to a Chairman Richard Purdey, great-g great grandson of the fou

says Purdey shotguns "have remained much the same since...the 1880s." The Purdey family sold the company after World War II. Since 1994 it has been owned by Compagnie Financière Richemont.

Making guns the Purdey way takes
t 500 hours of handwork at its facto-
n Hammersmith, in West London.
es start at around $89,000 for side-by-
game guns, so named because of the
tion of the two barrels. Over-and-un-
models start at about $105,000. Elab-
e engraving on the metalwork and
r custom features can add tens of
isands of dollars to the price.

ver time the guns have proved to be
od investment. Joe
, who owns a gun
er called Matched
s in England's
nty Durham, reck-
a gun made in the
)s, which might
cost $600, would in good condition
n about $27,000 today. Buy a new
, however, and its value is likely to
in the short term, especially if you
Britain's 17.5% value added tax (U.S.
lients are exempt).

RARE Purdey makes some 75 guns a year. Prices start at $89,000

ike Savile Row suits, Purdey guns are
oke—crafted to fit the shooter—usu-
through measurements taken by a
t London Shooting School instructor.
vill use a "try gun," which can be ad-
ed until size and sight lines are per-
Purdey stocks new guns in its South
ley Street shop for customers who
t want to wait 12 or more months for
stom job. The company produces only
it 75 guns a year. Nearly all are shot-
s, which shoot a spray of pellets for
ng birds or flying man-made targets.
go to U.S. customers. One such
haser is Leslie H. Wexner, CEO of Limited Brands Inc. About 15% go to collectors who likely will never shoot them.

At the factory, some 35 workers, all men, ply their trade at long wooden benches cluttered with metal scraps and hand tools. Recently, Robert Seddon was filing a pair of gun barrels to Purdey's distinctive, flowing shape and boring out the insides with a lapping machine that cuts finely with a mixture of emery paste and oil. "They need to be able to hit the same spot at 40 yards," he says.

PERFECT BALANCE

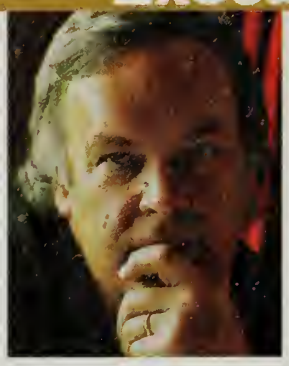
PURDEY CRAFTSMEN achieve extraordinary precision with handwork. Philip Butcher uses a can of burning oil to smoke the edges of the joint between the barrels and the rest of the gun to help create a tight seal. He snaps it shut, then opens it, and files the imperfections still coated with smoke. Repeated over and over, this process can shave metal to within a thousandth of an inch, he says.

Seven different crafts are represented in the shop. Purdey prizes stockers, who carve blocks of walnut, purchased from the Kurdish region of Turkey for $1,200 a pop into elegant gun stocks, or bodies. Mark McCarthy, a stocker, says the most demanding part of the job is chiseling in the rich, checkered pattern that goes on Purdey guns. He puts in up to 100 hours, squeezing in 20 to 30 lines per inch in a crosshatch pattern. McCarthy also bores hollow cylinders in the stock to make the gun lighter and "slightly nose-heavy" so it seems more agile.

Decoration on Purdey guns has long been understated. That is no longer what some clients want. In fact, the great change of the past few decades has been the emergence of artist engravers, whose work can overshadow that of the gunmakers. The best known of these independent engravers is Ken Hunt, who began as an apprentice at Purdey in the 1950s and also worked for legendary engraver Harry Kell. In his workshop on the top floor of his house in Surrey, Hunt inlays vivid representations of game animals into the metalwork using colored gold. He commands about $90,000 over the gun's price. At 70, he has cut back to about four guns a year.

Certainly, the guns I shot performed beautifully. To my surprise I broke most of the targets until Tim Cole, my instructor, had me try hitting clay birds coming off a 60-foot tower—a tough assignment. Cole's sage guidance helped. But using such pedigreed guns seemed to make things a lot easier. ■

BusinessWeek online For a slide show on Purdey shotguns, go to businessweek.com/extras



BY ROBERT PARKER

Buy Now, Savor Years From Now

INVESTING IN WINE FUTURES—and this is the season to do it—is really just buyi a case of wine, except for a few significant details. The wine, now the 20 vintage, is still aging in the barrel and won't be bottled and delivered fo couple of years. What's more, you don't know for sure what it's going to ta

like (although professionals can determine about 90% of the quality of the wine and the style of the vintage).

The weather in Bordeaux last year was excellent, and the vintage is quite good, but prices already reflect that. In fact, 2005 futures are nearly 60% higher than the 2004 vintage was at this point last year. In general, I don't believe the 2005 vintage will appreciate over current prices for years to come. That said, circa 2020, the startlingly high prices of the infant 2005s will look very low.

In short, the best reason to buy futures is because you really want the wine. Here are the questions to consider:

Are you buying a great wine or merely a wine from a great vintage?

Knowing who are the underachievers and overachievers is paramount to making a good buying decision. Futures on the 2005 Château Lafite-Rothschild, one of Bordeaux's elite first-growth wines, are around $500 per bottle. The wine is rated 93-96. (Ratings on barrel tastings are usually quoted as a range.) But you can buy Bordeaux rated nearly the same for a fraction of the price: Château Quinault l'Enclos, 92-95 points, $38 to $49 a bottle; Château Sanctus, 92-95 points, $38 to $48; Château Joanin Bécot, 92-94 points, $24 to $30; Château Destieux, 92-94 points, $35 to $44. (Tasting notes can be found at businessweek.com/extras.)

Do you want to be guaranteed a top, hard-to-find wine?

A handful of small estates, particularly in Pomerol and St. Emilion, produce such limited quantities that buying futu the only way to get a case. Wines such Pomerol châteaux as Le Pir Conseillante, L'Evangile, and Lafleu hard to find in the marketplace. St. E ion estates such as L'Angélus, La M dotte, Valandraud, and Le Tertre-R boeuf produce wines that will impossible to find in two or three ye

> "Some small estates produce wines that will be impossible to find in two or three years"

Do you want other than standard 750-ml bottles?

You can request the wines be bottl your specifications. Sure, there is a charge, but if you want half-bottles right for daily drinking), the only w do it is through futures.

Who's selling the futures?

The future is a contract between you a merchant. If the merchant goes banl before delivery, you'll be just anothe secured creditor. Or the supplier the chant deals with could go bankrupt fraudulent. You may get a refund fro wine merchant, but you won't get wine. Finally, buy futures only from a chant who has received confirmed mitments from the supplier, and ask t the papers. ■

Visit **www.eRobertParker.com** for the Internet's most active wine bulletin boa tens of thousands of tasting notes, or t order his recent book, *The World's Greatest Wine Estates: A Modern Perspective*. You can also subscribe to Parker's newsletter, *The Wine Advocate* Request a sample copy from *The Wine Advocate*, P.O. Box 311, Monkton, Md., 2

Wines rated from 96-100 are extraordinary; 90-95, excellent; 80-89, above average to very good. For more Parker picks, go to businessweek.com/e

Are you sitting down? The wall is now storage. →

← And storage is now the wall.

← This all makes for a super efficient footprint.

r wall is your storage and your storage is your wall, you can add employees without adding space.
ow the efficient, durable Reach™ office gets more floor out of your floorplan at AllsteelOffice.com.

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So You Wanna Be a Director

Companies are desperately seeking women to fill their boards. Interested? Here are some tips for getting there. **BY TODDI GUTNER**

WHAT'S ONE OF THE most hotly sought after assets for corporate boards these days? A female director. So you might think qualified candidates wouldn't have any trouble finding a slot. But many women with the types of résumés companies want don't know either where to start their search or how to market themselves to interested boards. That's where OnBoard Bootcamp and programs like it come in (table). These cram sessions coach female board-member wannabes on everything from creating a search strategy to understanding corporate governance rules. Most important, they teach that becoming a director is a matter of trust and compatibility. "It gets down to one thing: If this board blows up like an Enron, will I want to be in a foxhole with these folks?" says Theodore Dysart, managing partner for Heidrick & Struggles' Global Board of Directors Practice.

Prepping for a board seat in today's post-Enron/Tyco/WorldCom world is more important than ever. Such issues as accounting scandals, inflated compensation, and backdated options have increased the liability exposure and scrutiny of all directors. Plus, a board seat is a bigger commitment than ever, requiring about 250 hours a year. These factors help explain why companies are restricting top executives from serving on more than one outside board.

Still, landing a seat at a boardroom table is alluring, especially for women, who make up only about 16% of directors of the top 200 Standard & Poor's 500 companies, according to *Spencer Stuart 2006 Board Diversity Report*. Dysart says even with all the negative publicity, corporate board slots are desirable because "they provide an intellectual challenge, camaraderie, attractive pay [up to $160,000 on average for the top 1,000 companies], and they're good for professional growth." As further evidence, officials with these four director development programs all say demand exceeds capacity.

In June, *BusinessWeek* got exclusive access to an OnBoard Bootcamp session in Manhattan. For two days, 10 senior-level women executives got the chance to pepper experts with questions about the ins and outs of becoming a director (five men also attended). They came from fields ranging from marketing to the military.

The answers came easily to the co-founders of OnBoard Bootcamp, Susan Stautberg and Car Chin. Stautberg is president of Part Com, a company that assembles advi boards and conducts corporate b searches. She also founded Women porate Directors, a network of 195 m bers of nearly 400 boards. Chin is CE Cebiz, a New York business consul

(LEFT TO RIGHT) SEAN KELLY; JASON TANAKA BLANEY

and investment firm, and serves on five boards, including that of software provider Commtouch.

The sessions are sprinkled with informal talks from directors and recruiters. Some advice about how to conduct a search can be summed up in these steps:

Before you do anything else, Google yourself. If your name doesn't pop up, you've got a problem," Chin says. Search firms and companies see media presence as a sign of candidate credibility. "enhance your Googability," Stautberg advises writing articles and opinion pieces, and making sure that achievements, such as how you turned around a division, get public recognition.

Boot Camp for Board Wannabes

PROGRAM/CONTACT	COST	DESCRIPTION
Boardroom Bound	**$1,500**	Two-day program, four times a year, in various cities. boardroombound.biz
OnBoard Bootcamp	**1,495**	Two-day program, four times a year, in New York. onboardbootcamps.com
Women's Director Development Program	**4,800**	Northwestern's Center for Executive Women offers 2½-day program twice a year in Evanston, Ill. kellogg.northwestern.edu/exceed/program
Women On Board	**2,250**	1½-day program offered once a year in Philadelphia. the-leaders-edge.com

Hone your "elevator pitch." You need to be able to sell yourself to a recruiter or board member in 90 seconds or less. Bootcamp participants had to briefly explain why they would make good directors. Those who went on too long were cut off. Chin and Stautberg tried to help participants put forth one credential that would make them stand out. "You will be boiled down to one or two words, so think about what you want to be remembered for," says Chin. A fashion executive, for instance, spelled out how her licensing experience could be used to forge new markets and build a brand.

If you don't have corporate board experience, serve on advisory or nonprofit boards. Corporate divisions will assemble advisory boards to brainstorm new ideas or work through specific problems. A directorship on an advisory or nonprofit board increases your visibility and can be excellent training for the step up to a corporate seat. It shows your capacity for working in a group, widens your network, and expands future opportunities. Near the end of the second day, Stautberg put forth a couple of open advisory board positions that participants could apply for. One was to help a well-known wholesale club with distribution for a new business venture.

BUILDING STREET CRED Stautberg and Chin tell women how to achieve higher profiles

Be an interviewer as well as an interviewee. Chin's favorite question to ask a CEO or board chairman: "What keeps you up at night?" It can tell you a lot about the company. You'll also want to research what skills the other directors bring to the table and what skills the board needs. If you have a strong financial background, you can't go wrong offering to be on the audit committee.

Make sure you're protected. During the interview process, ask companies the size and limit of their directors' and officers' insurance policies. But don't stop there. "Check to see if the company has been sued, and if so, for what," says Chin. Review coverage levels with an outside risk manager. If you're not satisfied, request that the company consider buying an additional policy to cover independent director liability.

Stautberg and Chin worked with participants to retool résumés and bios. Instead of one bio starting, "Marge was born in New York City...," it was changed to "Marge is an innovative, globally connected, conservation science leader and author...." They encouraged Bootcamp grads to keep in touch for consultation. Mari Carmen Aponte, a Washington lawyer now on the board of Oriental Financial Group, a Puerto Rican bank, says her Bootcamp experience last year made her realize she needed more education. She has since attended an in-depth directors' course on compensation committees at Harvard University. Many business schools, including Stanford and Wharton, host directors' colleges where aspirants and sitting directors learn the basics of finance, governance, and ethics.

Ultimately, what gets you a board seat is your experience and verve, not your attendance at a seminar. But the prep can help you get in shape for the search.

Where the Market Will Be by 2007

Four on-the-money forecasters peer six months into the future. **BY BREMEN LEAK AND LAUREN YOUNG**

LAST YEAR'S CRYSTAL balls made for some sound gazing. The 76 stock market seers we surveyed last December for *BusinessWeek*'s 2006 Fearless Forecast expected the Dow Jones industrial average to hit 11,250 by midyear. On June 30 the Dow closed at 11,150, less than a percentage point below the consensus estimate. (In 2005, by contrast, the Fearless Forecasters were off 7% at midyear.) In fact, more than 20 strategists came within 100 points of predicting where the Dow would be at the end of June. An impressive collective performance, indeed.

We asked four folks who seem to have starkly different opinions to tell us what lies ahead for the market in the next six months. Barry Freeman, a strategist at HPC Capital Management, is expecting the sell-off that began in May will take the market down 11% by yearend; Christopher Conkey of Evergreen Investments and Hugh Johnson of Johnson Illington Advisors see stocks continuing to climb higher. Meanwhile, Warren Bagatelle of Loeb Partners expects the market to tread water for the rest of the year.

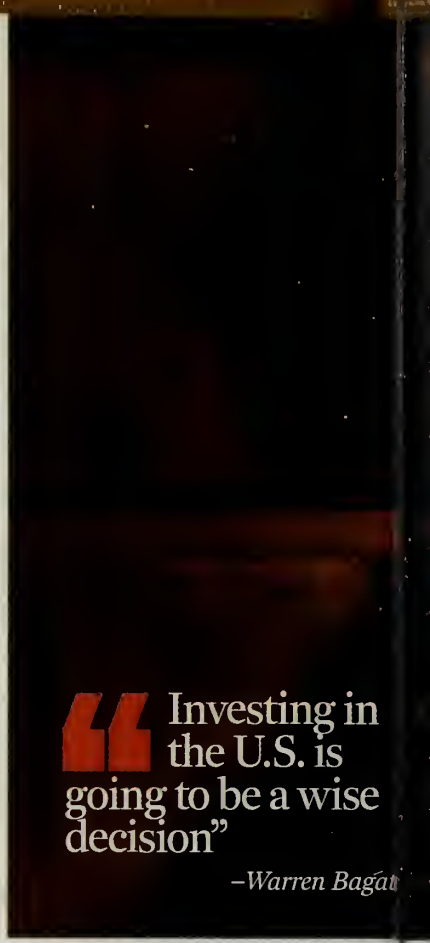
WARREN BAGATELLE

Managing Director, Loeb Partners

BAGATELLE, 67, SEES a relatively strong economy but is lukewarm about the stock market. Curbing his enthusiasm are political and emotional factors, such as war and corporate scandals, that he thinks can undermine investor confidence and turn consumers in other countries against U.S.-made goods. Another damper, he says, is the revolving door in the Bush Administration. "You plan on the policies and practices of a particular set of people, and suddenly those people are gone," he says.

Despite a market that he says will be choppy at best, Bagatelle's portfolio is largely in domestic stocks (69%), with no allocation overseas, a particularly contrarian view. "Investing in the U.S. is going to be a wise decision," he says. Bagatelle, who is based in New York, is bullish on Pfizer and the health-care industry. "People are living longer," he says, creating more demand for their products. He sees other opportunities in the smaller companies of the Standard & Poor's 500-stock index and the Russell 2000, which are less sensitive to macroeconomic trends and have faster growth rates than the megacaps.

Bagatelle's yearend target for the Dow is 11,150. An avid boater, he'll have plenty of time for sailing if the market stays calm for the rest of the year.



CHRISTOPHER CONKEY

Chief Investment Officer, Evergreen Investments

ALL BUT NAILING the markets this summer, Conkey and his nimble team of analysts are sanguine, to say the least. The 46-year-old strategist predicted a yearend Dow of 11,750—a slightly lower forecast than his earlier target of 12,000, but still more bullish than that of any other top midyear stockpicker. "We sa

A Fearless Forecast for 2006's **Second** Half

Here's where these four investment pros see the markets headed, and how they're planning for it

	YEAREND				ASSET ALLOCATION*			
NAME/FIRM	DOW INDUSTRIALS	S&P 500	NASDAQ COMPOSITE	RUSSELL 2000	U.S. STOCKS	INTL. STOCKS	U.S. BONDS	CASH
Christopher Conkey Evergreen Investments	11,750	1350	2325	720	50%	25%	20%	5%
Hugh Johnson Johnson Illington Advisors	11,600	1350	2300	670	80	0	15	5
Warren Bagatelle Loeb Partners	11,150	1365	2365	750	69	0	15	6
Barry Freeman HPC Capital Management	9,900	1165	2040	640	40	40	0	10

*Asset Allocations do not total to 100% in some cases because of allocations to other categories such as gold, REITs, hedge funds, derivatives ,and non-U.S. bonds

Data: *BusinessW*

ıg economy both domestically and ally," he says of the last six months. ıat's not to say Conkey isn't cautious. nidyear forecast of 11,000 was lower only 12 of the 72 others who provid- ıem. "The markets will face some winds going into the second half of ear," he says. Those include weaker umer spending and higher interest . "It may take several more tighten- before the economy cries 'uncle,'" ys. As long as the Fed keeps using in- t rates as a brake on the economy, he cts that inflation will not become ıg enough to hurt economic growth rnings potential.

ooking ahead, Conkey favors large- growth stocks, which he believes are rvalued, but he's leery of the tech r, which had been his favorite until recently. He's particularly worried the emerging options-backdating dal will hurt tech companies. "In the Enron world, even the hint of scan- ıakes investors uneasy."

RY FREEMAN

egist,
Capital Management

OUTLOOK from Freeman's perch in own Manhattan is not very bright. es the Federal Reserve continuing to short-term interest rates from % to 5.75%. In addition, as rates rise, more homeowners with adjustable-rate mortgages are going to get whacked, which means they'll cut back on consumer spending. "Many people living paycheck to paycheck will have some serious issues," Freeman says.

Decreased consumer spending will lead to softer corporate earnings. Freeman thinks inflation fears will grip investors and put downward pressure on the dollar. These fears will also push up the price of gold to $750. That's why he recommends stashing 10% of your portfolio in gold, either through an exchange-traded fund or with mining company shares. The Dow, he figures, will be around 10,200 in December.

As dire as this sounds, Freeman, 28, still thinks investors should keep about 40% of their portfolios in U.S. equities, while allocating another 40% to bonds and 10% to cash. In his spare time, Freeman plays golf and lends his support to his hometown baseball team, the Atlanta Braves. "Right now they need it," he says. The prospects for his favorite team are as dim as his forecast for the market.

> "People living paycheck to paycheck will have some serious issues"
> *–Barry Freeman*

HUGH JOHNSON

Chief Investment Officer, Johnson Illington Advisors

FOR MUCH of his 40-year investment career, Hugh Johnson has focused his attention on the bond market. "I've had more success forecasting interest rates than stock prices," says Johnson, 65, who was surprised to learn that his midyear stock market forecast was on target.

Now he's upping the ante, boosting his yearend forecast for the Dow from 11,450 to 11,600. "Corporate earnings will expand, and the Fed will stop raising short-term interest rates," he predicts. "That combination should be good enough to drive the stock market up 5% or more from current levels."

When we polled Johnson last December, he picked technology as his favorite sector. While corporate technology spending hasn't been as robust as Johnson anticipated in the first half of the year, he expects it to pick up in the third and fourth quarters. Although General Electric, his favorite stock for 2006, is not a pure technology company, he thinks it will benefit from that spending. He argues that GE will get an added lift as investors shift to large-company stocks after more than six years of focusing on small caps.

In February, Johnson and a few partners took over the asset-management arm of his former employer, First Albany, and renamed it Johnson Illington. Being in charge of more than $670 million in client assets, as well as eight employees, is a new experience that keeps him up nights.

The real source of his angst, however, is the Federal Reserve. Most worrisome is Chairman Ben Bernanke's "singular focus on inflation and adamant insistence on having a 2% or lower core consumer inflation rate," Johnson says. Since the Fed has hinted that the rate hikes may end, so may Johnson's worries. If his market forecast comes true, that may make him feel better, too.

EDITED BY MONICA GAGNIER

TAX HELP

HAGGLING FOR MERCY FROM THE IRS

BIG CHANGES ARE COMING if you owe a bundle in back taxes but can't afford to pay the entire bill. Through a program called Offer in Compromise, the Internal Revenue Service allows you to clear your debt by paying just part of what you owe. Last year the IRS accepted about 14,000 reduced payment offers, or about 20% of the proposals it received. When it made a deal, it settled for an average of about 16% of the taxpayer's liability.

But as of July 16 it will become tougher for some taxpayers to strike a bargain. To start, you'll have to send the IRS as much as 20% of your offer even to request a settlement. Today, you pay only a $150 fee. The good news is that the agency will have to respond to your offer within two years. Today, the IRS can take as long as it wants to get back to you.

To get a settlement, says Harris Abrams, an analyst with the tax research firm RIA, you'll usually need to prove you can't afford to pay the full bill. That can mean opening up all of your financial records to the agency, including bank and brokerage statements and mortgage documents. There is no magic formula. The agency decides each case on an individual basis. The burden is on you to convince the IRS that you cannot pay. You may also be able to negotiate a reduction in interest and penalties if you can prove that you were relying on IRS advice when you filed the disputed return.

If there are big bucks at stake, seek help from a tax pro. Be sure to use a legitimate professional and avoid so-called offer mills. These are outfits, often with slick Web sites, that guarantee they will get you a generous settlement, even if you can't document your argument that you can't afford to pay.

–Howard Gleckman

INVESTING

Smart Sector Bets

MOST INVESTORS KNOW about the benefit of diversifying across global stock mark But as the world's largest markets have started to move more in sync, it's becom important to diversify across industries, as well. Kate Phylaktis, a professor at London's Cass Business School, and Lichuan Xia, an equity analyst at Guotai Ju Securities in Hong Kong, looked at nearly 5,000 stocks in 34 countries over a de through 2001. During this time, major markets acted more and more alike, but t performance of industries became more varied. Semiconductors, consumer serv and biotech stocks increasingly zigged when the overall market zagged.

The upshot? Broad-based international funds heavily invested in developed nations may not be providing much diversification benefit. Look at the portfolios your international funds to see the industry concentrations, advises Phylaktis. Market indexes in Australia and Canada are heavily weighted toward basic materials, while the Standard & Poor's 500-stock index and the Swiss market contain large bets on the financial sector. Adding a small position in a global industry-focused fund can help improve diversification.

–Aaron Pres

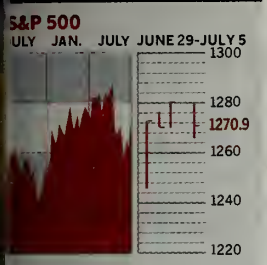
WHERE THE MONEY IS

FORGET BEVERLY HILLS. The city with the highest percentage of millionaires is tucked away in northern New Mexico. Almost 10% of the nearly 19,000 residents of Los Alamos are millionaires. That's the highest of any U.S. metropolitan statistical area, according to Phoenix Marketing International in Rhinebeck, N.Y.

CITY	MILLIONAIR
Los Alamos, N.M.	9.7
Naples/Marco Island, Fla.	8.4
Bridgeport/Stamford/Norwalk, Conn.	7.2
Vero Beach, Fla.	7.2
San Jose/Sunnyvale, Calif.	6.9
Sarasota/Bradenton/Venice, Fla.	6.7
Easton, Md.	6.7
Hilton Head Island/Beaufort, S.C.	6.6
San Francisco/Oakland, Calif.	6.6
Honolulu, Hawaii	6.6

gures of the Week

CKS



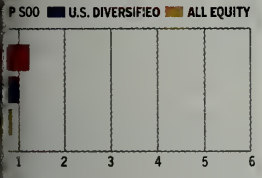
MENTARY

tock market rose 2% for the , but had some second ghts. All of the gains came 29 when the Dow shot up oints as traders decided ed is wrapping up its paign of interest rate hikes ut having crushed the omy. Then the mirth faded orries over Korean missiles, ngs, and maybe more rate

loomberg Financial Markets, Reuters

TUAL FUNDS

EEK TOTAL RETURN
ENDED JULY 4



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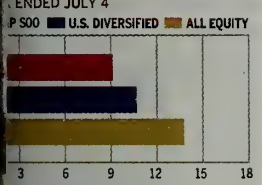


Standard & Poor's

U.S. MARKETS	JULY 5	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1270.9	2.0	1.8	5.5
Dow Jones Industrials	11,151.8	1.6	4.1	7.5
NASDAQ Composite	2153.3	2.0	-2.4	3.6
S&P MidCap 400	758.5	2.6	2.8	8.9
S&P SmallCap 600	374.1	3.7	6.7	10.0
DJ Wilshire 5000	12,799.0	2.2	2.4	6.6
SECTORS				
BusinessWeek 50*	723.1	2.2	-2.5	0.8
BW Info Tech 100**	375.5	3.1	-1.3	5.9
S&P/Citigroup Growth	586.4	1.7	-1.7	2.1
S&P/Citigroup Value	683.0	2.3	5.5	9.0
S&P Energy	427.4	4.2	14.7	18.6
S&P Financials	435.6	2.1	2.2	9.0
S&P REIT	171.5	4.2	12.1	12.4
S&P Transportation	283.1	2.8	13.3	36.3
S&P Utilities	164.6	2.0	3.1	1.6
GSTI Internet	172.4	1.8	-16.0	5.8
PSE Technology	779.9	1.7	-6.8	3.5

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	JULY 5	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1660.5	4.6	9.8	24.4
London (FT-SE 100)	5826.7	2.6	3.7	12.3
Paris (CAC 40)	4921.3	3.1	4.4	15.7
Frankfurt (DAX)	5625.6	3.1	4.0	22.2
Tokyo (NIKKEI 225)	15,523.9	4.3	-3.6	33.6
Hong Kong (Hang Seng)	16,267.2	3.3	9.3	15.2
Toronto (S&P/TSX Composite)	11,626.4	2.6	3.1	15.4
Mexico City (IPC)	19,514.6	7.8	9.6	43.0

FUNDAMENTALS	JULY 4	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.84%	1.91%	2.03%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.2	16.6	19.0
S&P 500 P/E Ratio (Next 12 mos.)*	14.0	13.9	15.3
First Call Earnings Surprise*	8.90%	5.36%	1.43%

*First Call Corp.

TECHNICAL INDICATORS	JULY 4	WEEK AGO	READING
S&P 500 200-day average	1262.6	1261.8	Positive
Stocks above 200-day average	59.0%	43.0%	Negative
Options: Put/call ratio	0.80	0.80	Positive
Insiders: Vickers NYSE Sell/buy ratio	2.73	3.06	Negative

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Motorcycles	7.8	Steel	134.0
Internet Retailers	6.8	Agricultural Products	96.5
Diversified REITs	5.8	Divsfd. Metals & Mining	73.5
Airlines	5.0	Constr. & Engineering	63.8
Drug Chains	4.9	Oil & Gas Equipment	60.9

WORST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Electric Mfg. Svcs.	-14.4	Educational Services	-34.9
Instrumentation	-11.4	Homebuilding	-33.3
Tires & Rubber	-11.1	Tires & Rubber	-32.1
Home Furnishings Rtlrs.	-9.4	Automobiles	-25.4
Communication Equip.	-9.2	Home Entertainment	-23.8

EQUITY FUND CATEGORIES 4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEAOERS	
Latin America	6.8	Precious Metals	74.1
Natural Resources	3.2	Latin America	58.4
Real Estate	2.8	Diversified Emrg. Mkts.	37.8
Precious Metals	2.3	Natural Resources	37.1
LAGGAROS		LAGGARDS	
Technology	-0.4	Health	5.5
Japan	-0.3	Domestic Hybrid	6.6
Europe	-0.1	Large-cap Growth	7.5
Diversified Pacific/Asia	0.1	Large-cap Blend	9.0

EQUITY FUNDS 4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEAOERS		LEADERS	
DireXion L. Am. Bl. 2X Inv.	10.6	Midas	113.2
ProFunds Prec. Mtls. Inv.	8.9	U.S. Global Invrs. Gold	109.3
PowerShares Enrgy. Explor.	8.3	U.S. Glbl. Invs. Prc. Mnls.	101.0
iShares D.J. U.S. Oil Explor. Idx.	8.3	ING Russia A	92.1
LAGGARDS		LAGGAROS	
Ameritor Investment	-25.0	Ameritor Investment	-75.0
PowerShares Enrgy. Explor.	-12.6	American Heritage Growth	-33.3
DireXion Emrg. Mkts. Sht.	-12.0	DireXn. Sm. Cap Br. 2.5X Inv.	-24.9
Frontier MicroCap	-9.5	ProFds. USh. Sm. Cap Inv.	-23.1

INTEREST RATES

KEY RATES	JULY 5	WEEK AGO	YEAR AGO
Money Market Funds	4.71%	4.62%	2.74%
90-Day Treasury Bills	5.01	4.99	3.16
2-Year Treasury Notes	5.24	5.28	3.79
10-Year Treasury Notes	5.22	5.25	4.11
30-Year Treasury Bonds	5.27	5.28	4.36
30-Year Fixed Mortgage†	6.72	6.76	5.47

†BanxQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BONO
General Obligations	4.21%	4.58%
Taxable Equivalent	6.01	6.54
Insured Revenue Bonds	4.27	4.64
Taxable Equivalent	6.10	6.63

THE WEEK AHEAD

ALLMENT CREDIT *Monday, 10, 3 p.m. EDT* » In May umers most likely assumed billion more of debt, after g on $10.6 billion in April. s the median forecast of omists polled by Action omics.

RNATIONAL TRADE *nesday, July 12, 8:30 EDT* » The foreign trade it probably widened to $64.6 n in May from $63.4 billion in April. The May rise in imports is expected to have outpaced the gain in exports.

FEDERAL BUDGET *Thursday, July 13, 2 p.m. EDT* » The federal government is forecast to have posted a $23.3 billion surplus in June. The May deficit was $42.8 billion.

RETAIL SALES *Friday, July 14, 8:30 a.m. EDT* » Retail sales probably grew 0.5% in June, after edging up 0.1% in May. Minus autos, June sales likely rose 0.4%, following a 0.5% jump in May.

EXPORT-IMPORT PRICES *Friday, July 14, 8:30 a.m. EDT* » June export prices are expected to have increased 0.4%, after a 0.7% jump in May. Import prices most likely rose 0.5%, following a 1.6% surge in the prior month.

BUSINESS INVENTORIES *Friday, July 14, 10 a.m. EDT* » May inventories probably climbed 0.3%, after a 0.4% rise.

The *BusinessWeek* production index was virtually unchanged at 282 for the week ended June 24, a 14.6% gain from the previous year. Before calculation of the four-week moving average, the index eased to 280.7.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras

BY GENE G. MARCIAL

PRIVATE INVESTORS MAY BE LICKING THEIR CHOPS OVER CBS.

WATCH FOR BRAZIL'S SABESP TO COME SURGING BACK.

ACACIA TECHNOLOGIES HAS INKED A FLURRY OF LICENSING PAC

Carve-Up Ahead at CBS?

WITH CBS (CBS) STOCK up from 25.50 to just 26.74 since the spin-off from Viacom on Jan. 3, some think the patience of Sumner Redstone, chairman of both Viacom and CBS, may wear thin. Unless things improve, Redstone, who controls 73% of the Class A voting stock of both, may opt for a CBS breakup, believes Mark Boyar of Boyar Asset Management, which owns shares. He was one of the first investors in Dow Jones to urge its board last year to sell. Nothing may happen for a year, but private equity investors are starting to look. The assets of CBS, which has a market cap of about $20 billion, are worth 40 a share, he figures. Boyar thinks a breakup would be logical, given CBS's "extraordinarily low valuation and the obvious value" of its assets. Viacom held on to Paramount Home Entertainment, MTV, and Nickelodeon. But CBS has TV networks, 178 radio stations, and billboards, says Boyar. The company just sold its theme parks to Cedar Fair for $1.2 billion. Richard Bilotti of Morgan Stanley, which has done business with CBS, notes that CBS is trying to sell radio stations in 10 markets. That could fetch $670 million to $720 million, he figures. Some analysts don't expect much lift from regular CBS business. Tuna Amobi of Standard & Poor's says the stock is under pressure because ad spending is down. He expects it to earn $1.69 a share in 2006 and $1.77 in 2007. Meanwhile, CEO Leslie Moonves is trying to nudge the shares up by improving CBS's network ratings and by raising dividends—the stock now yields 2.7%. CBS declined comment. Viacom spokesman Carl Folta also would not comment.

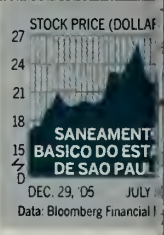
BIDING ITS TIME

Data: Bloomberg Financial Markets

São Paulo's Water May Not Stay Low for Long

EMERGING MARKETS got clobbered in recent weeks. Now investors are shopping for shares they think didn't deserve the hit. John Maloney M&R Capital Management says one such is Brazil's largest water utility, Saneamento Básico do Estado de São Paulo (SABESP). Its American depositary receipts trade on the New York Stock Exchange at 23.16; Maloney says they're worth 30. Cash flow is rising about 11% a year, and revenues 6%. In addition, yields 6.7%. The combo makes SABESP, 52% owned by the state government, a good way to bet on Brazil's economy, Maloney adds. The stock trades at 8.9 times his 2006 earnings forecast of $2.60 a share—much less than the 20 times earnings at which U.S. water utilities typically trade. He expects it will earn $2.75 a share in 2007 and $3 in 2008. Lilyanna Yang of JPMorgan Chase, which has done business with SABESP, rates the stock "overweight." She expects the utility to generate enough free cash flow f to be able to raise dividends and push the yield up to 8%.

DRAINED OFF



Data: Bloomberg Financial

Acacia's Lucrative Web Patents

SHARES OF ACACIA TECHNOLOGIES (ACTG), have doubled, to 14.69, since they were featured in this co in mid-December. The company, which controls 47 patent portfolios covering transmission and receipt of dig content, has room to run. The stock has yet to reflect recer licensing deals, says Harris Hall of Singular Research, the analyst who follows the company. He rates it a "buy," with a 12-month target of 17. On July 5, Acacia signed a pact with General Electric's GE Healthcare, the 26th pact since March. Other licensees include Advanced Micro Devices, Hewlett-Packard, IBM, Intel, Lenovo Group, and Nokia. Hall expects more deals before other patent-infringement lawsuits filed by Acacia go to trial later this year, including one against Microsoft. Already, Acacia has licensed its video-on-demand technology to 300 cable-TV and Web companies, includin Walt Disney and Bloomberg. Sony and Matsushita have s suits on audio enhancement. Hall expects Acacia to earn share on revenues of $90 million in 2007, vs. his estimate 2¢ loss in 2006 on $41 million.

TOP OF THE TREE

Data: Bloomberg Financial

BusinessWeek online Gene Marcial's Inside Wall Street is poste businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor firms hold positions in the stocks under discussion. Similarly, they have no invest banking or other financial relationships with them.

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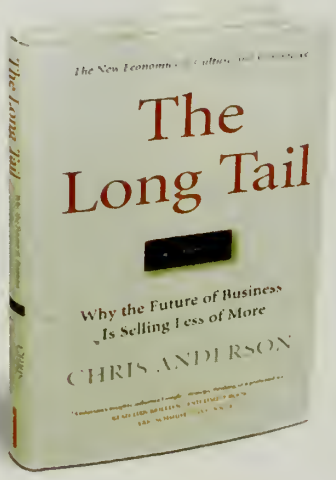
Who Needs Blockbusters?

THE LONG TAIL Why the Future of Business Is Selling Less of More
By Chris Anderson; Hyperion; 238pp; $24.95

Megahits sure aren't what they used to be. Television's top-rated show, *CSI: Crime Scene Investigation,* commands only 15% of TV households, compared with the 74% who were glued to *I Love Lucy* in the 1950s. The number of CDs reaching at least gold sales status has fallen by half since 2001—double the decline of overall music sales. And on the online DVD rental site Netflix, only 30% of movie rentals are new releases. What's up (or down) with the hits?



They're rapidly losing ground to what used to be called misses, contends *Wired* Editor-in-Chief Chris Anderson. In his book *The Long Tail: Why the Future of Business Is Selling Less of More*, Anderson makes a strong case that the mass market is giving way to a "mass of niches." The book's title refers to the long, tailing-off part of the demand curve for most products, following the high-selling hits at the curve's head. Anderson's key contention: As the Internet relentlessly cuts the cost of finding and distributing products, it's accelerating the arrival of entirely new markets for obscure books, movies, and even Lego kits that never made it to local stores and theaters.

The Long Tail has some shortcomings, including rather obvious advice on how businesses can tap into this dynamic. But it provides insights into the surprising new retail and cultural landscape. Using deeply researched examples, Anderson neatly knits together many of the Internet's seemingly disparate successes. Amazon.com's online store that boasts "Earth's biggest selection," the rise of millions of blogs on everything from politics to overheard conversations in New York, and Google's highly targeted search ads all are built on exploiting the long tail of products, services, and customers. "Those new markets that lie *outside* the reach of the physical retailer have proven to be far bigger than anyone expected—and they're only getting bigger," he writes.

Anderson shows how the outsize importance of hit products was actually a result of distribution bottlenecks that discouraged retailers from stocking anything but hot-selling products. Now niche products can be stocked efficiently in warehouses or superstores (or, in the case of digital goods such as downloadable music, on computer servers), ordered by anyone with a computer and a credit card and shipped cheaply anywhere in the world. Explains Anderson: "The economics of such distribution are changing radically as the Internet absorbs each industry it touches, becoming stor theater, and broadcaster at a fraction of the traditional co

That's clearly disruptive for some established players, as bricks-and-mortar retailers. But even if people seem t buying fewer hits, they may end up buying more product overall. That's because, thanks to the likes of Google, Am and eBay, they can find books, music, and other items mo targeted to their particular tastes—products they didn't k existed or couldn't find before. For instance, some 40% o sales at online music service Rhapsody are songs that are available in retail stores. And sales of those niche product can prove to be more profitable than hits since they requi marketing and essentially cost nothing to store on a hard drive.

That's true for digital media, at least— that points up one limitation of Anderson argument. He rightly notes that Google a eBay can be considered long tail business since they give thousands of tiny mercha affordable marketing venues for the first t Perhaps open-source software, which has independent programmers helping to ref code over the Net, and the volunteer-writ online reference work Wikipedia constitu long tail of talent. But Anderson also clai that flour and beer are ong Tail businesse matter how many varieties of each are no widely available, that seems a stretch. Bo face formidable distribution constraints t the Internet seems unlike reduce much.

Some 40% of sales at online music service Rhapsody are songs that aren't available in retail stores

The book also comes u short on practical advice anyone who wants to bui business catering to the l tail. In one eight-page chapter, Anderson reveal "secret": "1. Make everyt available," and "2. Help find it." You probably do need to read this book to figure that out. And the n specific rules he offers, su as "Move inventory way in…or way out" and "One price doesn't fit all," seem either cryptic or obvious.

Quibbles aside, *The Long Tail* illuminates hidden subtl of modern Western culture, so often portrayed as depress uniform. Writes Anderson: "What we thought was the ris tide of common culture actually turned out to be less abo the triumph of Hollywood talent and more to do with the sheepherding effect of broadcast distribution." It's reassu to learn that popular taste is more diverse than we thoug

-By Robert D

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IdeasOutside Shot

BY ANTHONY P. CARNEVALE

Hitting the Books Still Pays Of

An assault on the value of a college education is coming from an unlikely corner: prominent liberal economists. Where their ideological predecesso fought to open higher education's doors to the disadvantaged, influential voices on the Left have lately been declaring that the earning power of a college degree—long America's surest elevator of class—is overblown.

Sadly, this misguided message is being trumpeted by some pretty impressive thinkers. Jared Bernstein of the Economic Policy Institute moans that the wage premium for skills has fallen during the current business cycle. Princeton University's Paul Krugman goes further, saying college-educated workers are not sharing in the nation's recent prosperity, and "improving our educational system is not the way to mitigate inequality." And offshoring will so shrink the job market for the college-educated in the U.S., former Federal Reserve Vice-Chairman Alan Blinder warned recently, that many students would do better to pursue a trade or face-to-face personal service.

But this recent liberal cooling of opinion toward college seems to have more to do with politics than economics. By asserting that a college degree may no longer guarantee a good job, these policy wonks (many still fuming since Republicans took the Congress and President Bill Clinton lurched to the right in hot pursuit of a second term) can argue that only an expansion of the welfare state and national industrial policies can save us from global economic forces.

YET CASTING ASPERSIONS ON THE VALUE of college in order to resurrect shopworn ideas is not only factually inaccurate but also politically reckless. Americans across the political spectrum welcome the nation's increasing reliance on education as the arbiter of economic opportunity because, in theory, education allows us to expand merit-based opportunity without surrendering individual responsibility. After all, we each have to do our own homework to make the grades that get us into college, and thus in line for the "good" jobs. Education has become America's Third Way between runaway markets on the Right and welfare state dependency on the Left. So those who want to move this centrist education consensus more toward big government will eventually find themselves in a losing quarrel with the American people.

Views expressed in Outside Shot are solely those of contributors.

> Some on the Left say college no longer yields an economic advantage. Wrong

Politics aside, this is one argument these usually reliab experts deserve to lose based on facts. The wage advantag a college degree over a high school diploma increased by from 1979 to 2003, or about $1 million over a working ca And advantages for college grads have grown over the pe despite an 11% increase, equal to about 33 million new jo seekers, in the supply of college-educated workers. Krugr worries that the college wage premium increased by only per annum since 1975. *Only*? Where I come from an incre of 1% per annum compounded over 30 years is real mone

A recent pause in the growth of earnings advantages fo college grads seems to have fueled much of the current de over higher education's value. Average wage college grads did fall 3%, or about $1,600, fr 2001 to 2004. But such lulls are common in wage growth: Wages for the college-educate declined in the "jobless" economic recovery the mid-1990s, only to be followed by an explosion in both job growth and wage adva later in the decade. Moreover, the decline scenario may be a timing fluke: Use 2000 ra than 2001 as the base year, and average wag college grads actually increased by about $2,000, or 4%, by 2004.

Still, higher wages aren't the only payoff. Nearly 95% of full-time workers aged 25 to 5 with at least a bachelor's degree have health- coverage, while about 90% have retirement p Such coverage drops to 81% and 80%, respectively, for similarly aged workers with only high school diplomas.

Rather than discounting education, the evidence suppo the opposite: With the demise of blue-collar jobs that let workers with modest skills earn middle-class wages, colle is no longer just a preferred avenue to professional career is increasingly the only road to economic success. That's I bet none of those knocking higher ed's value are telling own kids to skip college. Until they do, their pronouncem are just bad advice for other people's children.

ANTHONY P. CARNEVALE, *a senior fellow at Education Secto former economist for the Senate Democratic Policy Committ*

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Ideas The Welch Way

BY JACK AND SUZY WELCH

So Many CEOs Get This Wron

If human resources is the most powerful part of an organization, as you always say, why is its impact felt in only a negative way?
–Fadi Rahal, Louisville, Ky.

Because human resources, unfortunately, often operates as a cloak-and-dagger society or a health-and-happiness sideshow. Those are extremes, of course, but if there is anything we have learned over the past five years of traveling and talking to business groups, it is that HR rarely functions as it should. That's an outrage, made only more frustrating by the fact that most leaders aren't scrambling to fix it.

Look, HR should be every company's "killer app." What could possibly be more important than who gets hired, developed, promoted, or moved out the door? Business is a game, and as with all games, the team that puts the best people on the field and gets them playing together wins. It's that simple.

You would never know it, though, to look at the companies today where the CFO reigns supreme and HR is relegated to the background. It just doesn't make sense. If you owned the Boston Red Sox, for instance, would you hang around with the team accountant or the director of player personnel? Sure, the accountant can tell you the financials. But the director of player personnel knows what it takes to win: how good each player is and where to find strong recruits to fill talent gaps.

Several years ago we spoke to 5,000 HR professionals in Mexico City. At one point we asked the audience: "How many of you work at companies where the CEO gives HR a seat at the table equal to that of the CFO?" After an awkward silence, fewer than 50 people raised their hands. Awful!

Since then, we have tried to understand why HR has become so marginalized. As noted above, there are at least two extremes of bad behavior. The stealthy stuff occurs when HR managers become little kingmakers, making and breaking careers, sometimes not even at the CEO's behest. These HR departments can indeed be powerful, but often in a detrimental way, prompting the best people to leave just to get away from the palace intrigue. Almost as often, though, you get the other extreme: HR departments that plan picnics, put out the plant newsletter (complete with time-in-service anniversaries duly noted), and generally drive everyone crazy by enforcing rules and regulations that appear to have no purpose other than to bolster the bureaucracy. They derive the little power they have by being cloyingly benevolent on one hand and company scolds on the other.

> HR has to be about more than palace intrigue—or company picnics

So how do leaders fix this mess? It all starts with the p they appoint to run HR—not kingmakers or cops but big- leaguers, men and women with real stature and credibili fact, managers need to fill HR with a special kind of hybri people who are part pastor (hearing all sins and complai without recrimination) and part parent (loving and nurturing, but giving it to you straight when you're off tr

PASTOR-PARENT types can come up through the HR department, but more often than not, they have run something during their careers, such as a factory or a function. They get the business—its inner workings, hist tensions, and the hidden hierarchies that exist in people' minds. They are known to be relentlessly candid, even wl the message is hard, and they hold confidences tight. Wit their insight and integrity, pastor-parents earn the trust c the organization.

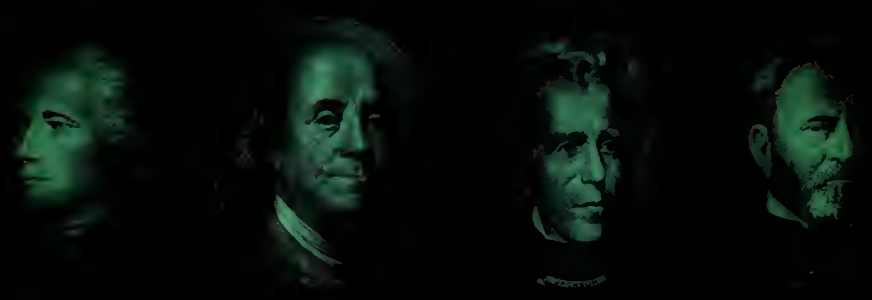
But pastor-parents don't just sit around making peopl feel warm and fuzzy. They improve the company by overseeing a rigorous appraisal-and-evalua system that lets every person know where l she stands, and they monitor that system w the same intensity as a Sarbanes-Oxley compliance officer.

Leaders must also make sure that huma resources fulfills two other roles. It should create effective mechanisms, such as mone recognition, and training, to motivate and retain people. And it should force organiza to confront their most charged relationshi such as those with unions, individuals who no longer delivering results, or stars who a becoming problematic by, for instance, swe instead of growing.

Now, considering your negative experien with human resources—and you are hardly alone—this k of high-impact HR activity probably sounds like a pipe dr But given the fact that most CEOs loudly proclaim that pe are their "biggest asset," it shouldn't be.

It can't be. Leaders need to put their money where thei mouth is and get HR to do its real job: elevating employe management to the same level of professionalism and integrity as financial management. Since people are the v game, what could be more important? ■

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at **thewelchway@businessweek.com.** *For their weekly podcast, go to www.businessweek.com/search/podcasting.htm*



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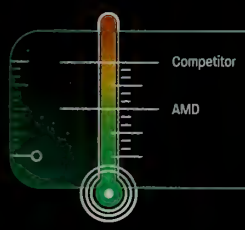

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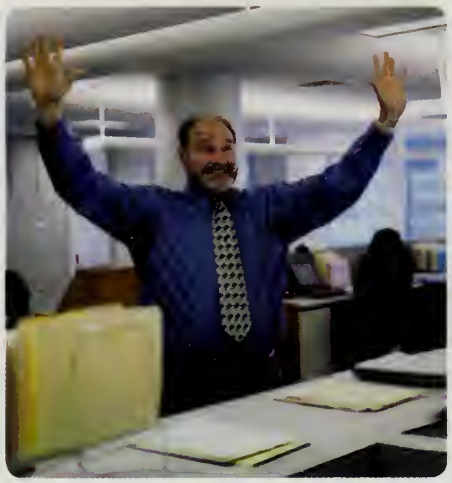

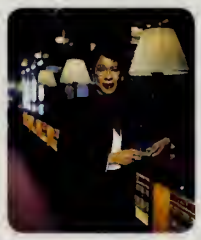

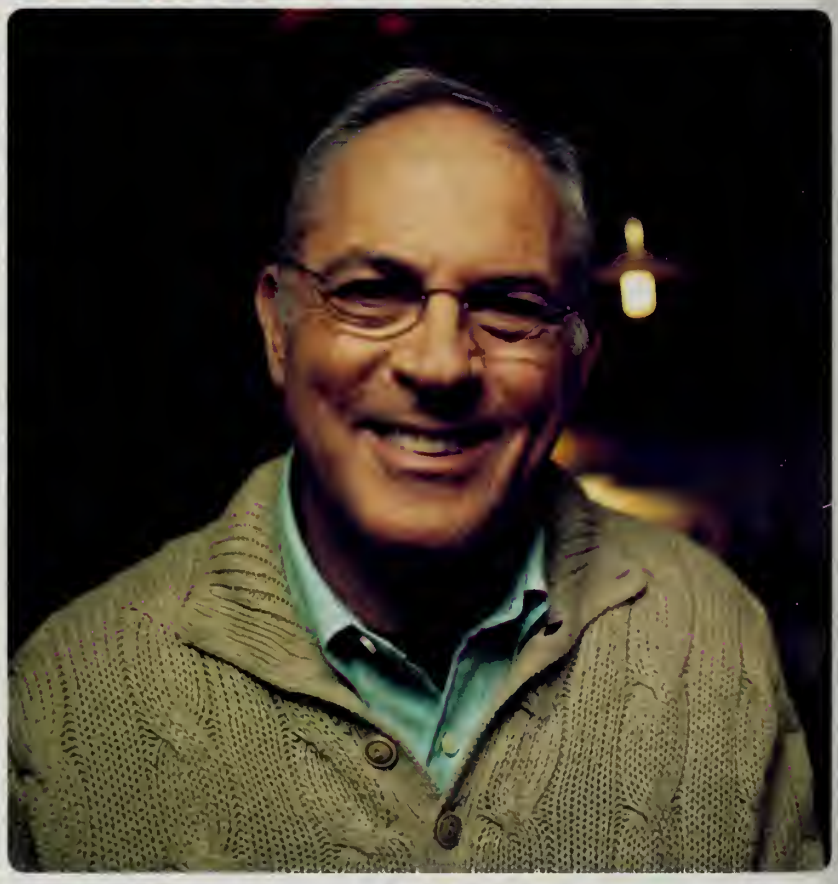

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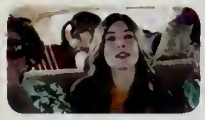

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Tall bosses

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She bosses

They bosses

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July 24, 2006

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THE WALL STREET JOURNAL.

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FRIDAY, AUGUST 29, 2003 ~ VOL. CCXLII NO. 43 ~ **** $1.00

When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

LIQUOR BRAND/PRICE*	OUR AWARD
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Hendrick's $30/750ml	Most Flavorful
Tanqueray No. Ten $26/750ml	Smoothest
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V-Phone: Vonage's USB device plugs int PCs for calls on the g

Make the (Internet) Call

A growing number of companies are ripping out their old phone systems to install gear that delivers calls in the same way that e-m sails over the Internet. The impetus for an upgrade to a **Web phone system**: the prospect of dramatically lower bills. But as BusinessWeek.com's **CEO Guide to Technology** explains, there are hidden risks, and the desired savings may not kick in for several years. To help navigate this terrain, we offer **10 tips** for any executive interested in joining the Internet phone vanguard as well as a podcast with consultant Jeff Snyder that outlines the costs and benefits of putting voice traffic over the same network that handle computer data. To check out **the latest in feature-rich Internet phones**, through a slide show. Then find out how Digium CEO Mark Spen uses free Linux software to create **a low-priced phone system** for companies, and how a new service called efonica is trying to bring Web-based calling to emerging markets. For all this and more, go **www.businessweek.com/go/06webphone**

Microsoft's prototype business phon

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:verywhere in the future.

future begins today, before your very eyes, and is embodied in Finmeccanica's new corporate logo. A logo that symbolizes orld in which our Group is becoming an ever more competitive force thanks to its technology and systems. It's a logo :, in the USA as much as in the world, represents a partner with the capability of modeling its leading expertise in order to mplish specific demands and achieve reliable solutions in different sectors: from aeronautics to helicopters, from public nsport, alternative energy power plants to defense electronics. The future starts here. And knows no boundaries.

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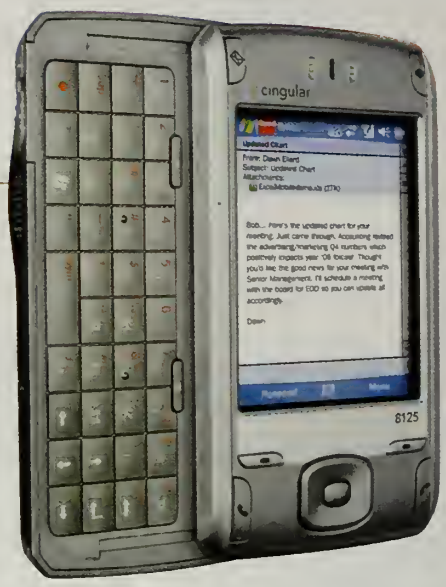

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JP Front

"You can't spend it, even if you try. I've been trying."
–Oracle CEO Larry Ellison speaking to reporters on his 452-foot yacht about his plan to eventually give "almost everything" to charity, as reported in London's Daily Telegraph

TED BY DEBORAH STEAD

ADE WINDS
HE WORLD GAINST HE YUAN?

NA'S just-announced trade plus for June—a record .5 billion—may actually good news for the Bush ninistration. Such a large nber is munition for Treasury ot., which been ng uccessfully get Beijing to e the value of its currency inst the dollar. n the past, when shington pushed China to alue the yuan, Beijing nted to its trade deficits h other countries to show t it was not keeping the ue of the yuan artificially ressed to aid its exports.

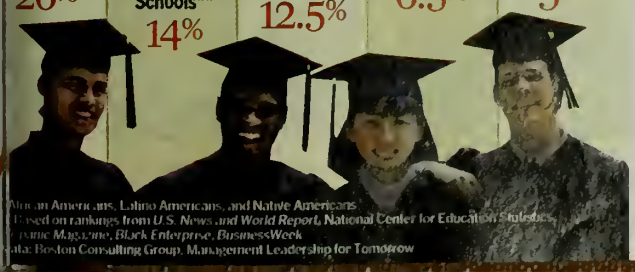
Now, as China's growing surplus shows, those deficits have shrunk or even disappeared, partly because of the country's tightened economy and slowed imports. Thus the U.S. can argue its case with "a stronger voice," says China expert Albert Keidel at the Carnegie Endowment for International Peace. The June number, up from a previous record of $13 billion in May and nearly 50% above the surplus recorded a year ago, may also prompt other world leaders to step up pressure on China. Exchange rates are expected to be on the agenda of the G-8 economic summit in St. Petersburg, Russia, where Chinese President Hu Jintao is scheduled to be a guest.
–Peter Coy and Catherine Yang

HE BIG PICTURE

INORITIES prefer law and medical school to siness school, according to Management adership for Tomorrow, a nonprofit group rking to increase minority access to the ranks senior management. *–Janie Ho*

ERCENT OF MINORITIES* IN:

U.S. Population	College Graduating Class, Top 100 Schools**	Top Law and Medical Schools**	Top 30 MBA Programs**	C-Suite, U.S. Companies
26%	14%	12.5%	6.5%	3%



frican Americans, Latino Americans, and Native Americans
Based on rankings from *U.S. News and World Report*, National Center for Education Statistics, *Fortune Magazine*, *Black Enterprise*, *BusinessWeek*
ata: Boston Consulting Group, Management Leadership for Tomorrow

MARKETING

Quick, Cue The Ketchup

ITS WACKY ads have rocked Mad Ave. Now **Burger King** is taking meetings in Hollywood. Execs at **Crispin Porter + Bogusky**, the fast-food giant's irreverent ad shop, have written a rough script for a Burger King-themed movie and are shopping it to such studios as **Twentieth-Century Fox** and **Universal Pictures**, according to **AdAge.com**. The script, which takes its cues from off-beat indie hits like *Napoleon Dynamite*, features characters who share an apartment above a Burger King outlet. "It is a very clever way to create buzz around the brand," says Alan Vituli, CEO of Carrols Corp., one of the largest Burger King franchisees, with 330 restaurants. If produced, the film is expected to cost less than $10 million, AdAge.com reports.

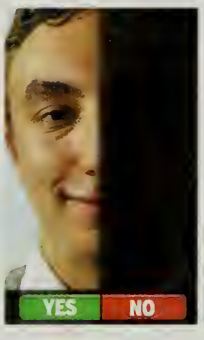
It's not the first time Miami-based Crispin has steered Burger King's marketing into a galaxy far, far away. In 2004 it launched the now-famous SubservientChicken.com (400 million hits and counting) to showcase the chain's Tendercrisp Chicken Sandwich. (The chicken obeys orders typed in by visitors to the site.) And last year, the agency created a Web site for a fake heavy metal group it dubbed Coq Roq. Burger King, which reports its first quarterly earnings as a public company on Aug. 1, declined to comment on the film script. *–Brian Grow*

UPFront

WEB WORLD

THE BLOG WITH THE VELVET ROPE

RECRUITERS USING the Web to learn more about potential candidates may soon find it harder to turn up photos of Dionysian behavior or tell-all blog posts. This fall, software company **Six Apart**—a supplier of blog-building applications for **Yahoo!'s** business Web-hosting clients—plans to launch **Vox,** a blogging and social networking site with highly customized privacy settings.



For each item a user posts—a photo, video, or chunk of text—the site, now in beta, will ask: "Who can comment on this?" or "Who can view this?" Users can say "the world" or restrict access to invited "friends" or "family." The system is more tailored than the all-or-nothing privacy options offered by many social networking sites. "It's mix-and-match," says Six Apart co-founder Mena Trott. Indeed, users can cultivate several online personas, even within a single blog, each aimed at different viewers.

Vox's focus on privacy settings, though ultraprecise, mirrors a trend among popular networking sites like **MySpace.com** and **Xanga.** Such sites are highlighting their privacy options in light of media reports about dangers that arise when sexual predators trawl the Web—alongside less menacing types, like employers. *–Reena Jana*

CRIME STORIES

THE LONG HISTORY of corporate fraud is now preserved in its own museum. The Association of Certified Fraud Examiners on July 9 unveiled a collection of business memorabilia it's heralding as a "frau museum." The project is the brainstorm of ACFE founder and Chairman Joseph Wells, and the collection of about 90 pieces so far includes stock certificates for Enron, WorldCom, and Adelphia Communications; a check signed by Ivan Boesky, who served tim for insider trading; and a copy of the short-liv 1950s magazine *Frauds and Rackets*, shown above. "Public education about fraud is part our mandate," says Wells. After a month on view at the Venetian Hotel in Las Vegas, the museum will be housed in ACFE headquarte in Austin, Tex. *–Elizabeth Woy*

BLOGSPOTTING

DESIGN FOR WORKING

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» **WHY READ IT** For practical insights about innovation and organizational life from Bob Sutton, a professor at Stanford's Engineering School. Sutton is a co-founder of Stanford's multidisciplinary "d.school," its design program, and co-director of its Center for Work, Technology & Organization. His blog reflects all these interests without being overly academic. And his opinions—about, say, the efficiency of holding meetings where everyone stands or the value of brainstorming—reflect his commitment to a "no jerk" work culture.

–Elizabeth Woyke

DRAWN & QUARTERED

"It's okay, Gretel. I met her on MySpace.com!"

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UPFront

COACHING

BEYOND INSTANT REPLAY

The bus ride home after a loss could seem a lot longer for some college football players this fall. CBS-owned College Sports TV is preparing to release a tool that allows players and coaches to watch games on video iPods right after the final whistle.

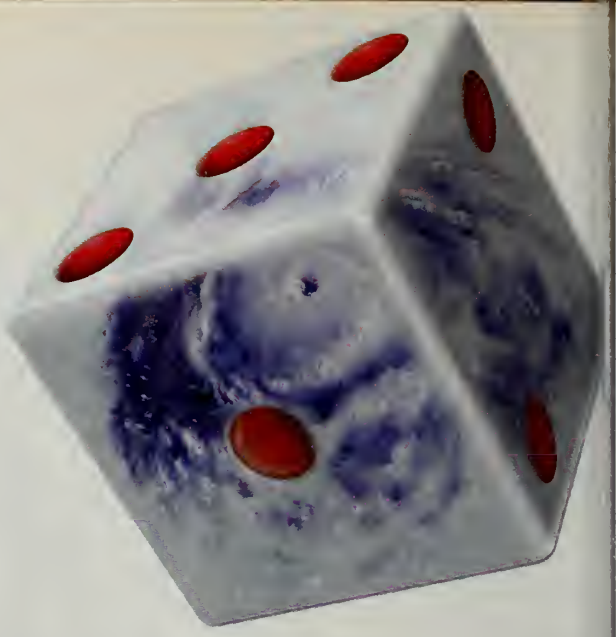
The Edge system is the first to catalog game footage into searchable files for immediate viewing on multiple iPods. "It's a step ahead of where a lot of people are at this point," says Eric Ruden, senior associate athletic director at the U.S. Naval Academy, who saw a demonstration at a meeting of collegiate athletic directors.

CSTV plans to market the system to Division I college teams before targeting pro football or other college and pro sports. The company won't discuss the price tag, but judging by the hardware (two MacBooks, a video converter, and at least 10 iPods), it will probably come in around $25,000—a modest sum for schools with big-money football programs.

–John DeBruicker

NET BETS

BETTING ON THE NEXT BIG ONE



THE HOUSE PASSED a bill against online gambling this week. But Congress isn't alone in lashing out against Web wagers. Sites like **betonsports.com** and **bodog.com** are coming under fire for offering bets on whether a major hurricane will slam into U.S. coastal areas. At bodog.com, for example, a $100 bet that a Category 5 storm will hit the U.S. by yearend currently will pay $350 to winners.

The betting sites' critics, including the meteorologists whose forecasts are used to lay odds, contend that such gambling is insensitive and morbid, given the loss of life and property that most major hurricanes cause. "Forecasts are there for people to help protect themselves, their lives, and their property," says **National Weather Service** spokesman Dennis Feltgen, who calls betting on hurricanes "sad."

The operators of the sites argue that they're providing a service their customers have requested. (They decline to divulge the number of bettors wagering on the storms.) And they add that much of the betting comes from residents of Hurricane Alley in Florida, Louisiana, and Texas. "People bet on what they're familiar with," says Kevin Smith, a spokesman for betonsports.com.

One site, **Wagerweb.com**, going a step further to def criticism. It takes bets only how many hurricanes will develop into major storms (Category 3 or higher), no how many will make landf CEO Dave Johnson even offered to donate hurrican bet proceeds to the **Americ Red Cross.** Since the agency declined (its charter forbic involvement in gambling), says the money will go to t **Humane Society.**

–Susan McM

ETHICS

THE DEVIL MADE ME DO IT

HOW DO cheaters justify their actions? An article in an upcoming issue of *Business and Professional Ethics Journal* offers some insights. Based on responses from university students, the authors identify four ways that people rationalize their unethical behavior: They distance themselves from the act, blame someone else for it, redefine it as a good thing, or conclude that the outcome (even a negative one) made cheating worthwhile.

Co-authored by three business professors at **Iowa State University** and their former colleague Tim West (now at the **University of Arkansas**), the article stems from a cheating incident experienced by West a few years ago, when he was a visiting B-school professor at a university he declines to name. After assigning a take-home test to the 64 students in his managerial accounting class, and unaware that another professor had posted an answer key on the Web, he found that at least two-thi of his students had looked the answers online. (Visit Internet addresses could b tracked from the site.)

West scrapped the test results, then surveyed the cheaters about why they h lifted their answers from t site. In their anonymous responses, some of those students said they didn't usually cheat and were "unsure" if what they did was dishonest. Others blamed West for giving a t whose answers were available. Still others focu on the valuable "lesson" t learned. Then there were those who cited the "fact" that "everyone cheats" an that "this is how business operates." *–Romy Druc*

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"Cynical as it may seem, these [ID] thefts may have an economic motive unrelated to the harvesting of the data involved."

–Karen Ann DeLuca
Alexandria, Va.

HOW TO REALLY ENCOURAGE INVENTIONS

RE "INSIDE NATHAN Myhrvold's mysterious new idea machine" (Cover Story, July 3) about Intellectual Ventures' approach to derive value from patents: As an inventor (with a patent issued to me recently), I must side with Myhrvold on his understanding of the mentality of the large corporations and the culture of infringement, and his trying to come up with a business model to get values for patents and, I hope, for inventors.

But I question the approach of buying it cheap from inventors—an offer of $50,000 for a patent can barely cover the inventor's cost of getting it issued. I encourage Intellectual Ventures to shift its business model from protecting its big investors (large corporations) to a genuine value system that is in the spirit of our patent law—to encourage inventions and the practice of inventions for the benefit of the public by rewarding the inventor.

–Ifay Chang
Katonah, N.Y.

INTELLECTUAL VENTURES could be either a boon or bane to our economy. Current patent laws allow patents on all sorts of dubious "inventions." The definitio invention needs to be strengthe Patenting business processes like click-shopping and other such obviou tensions of existing technologies just f the legal mill with a frictional drag or economy. Patenting "discoveries" suc naturally occurring compounds make sense: They weren't invented. On the er hand, a drug company that synthes a molecule that is demonstrated to pro some medical benefit deserves to have tection of its invention.

Because of the economic importan protecting true intellectual property, it hooves us to reform patent law an provide the U.S. Patent & Trademark fice with a much larger budget to staff itself with people of the caliber quired to evaluate patent applications to give them the time to do so.

–Peter M. Ca
Chief Financial Officer, TFD G
Los An

ID THEFT: SOMEBODY MUST BE MAKING A PROFIT

IF LAW ENFORCEMENT officials that criminals tend not to follow thro after stealing personal data, then wh

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Readers

it ("ID theft: More hype than har
News: Analysis & Commentary, July
Could it be that financial fraud is be
done for a business purpose? Th
about the increase in fraud-detec
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time there is a possible breach—or
number of consumers that flock to cre
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mention of the possibility that their s
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an economic motive unrelated to the l
vesting of the data involved.

–Karen Ann DeL
Alexandria,

DIRECT REVENUE: 'WE OBTAIN EXPLICIT CONSENT'

WE ARE COMPELLED to respond to
Elgin's recent article about Direct Reve
("The plot to hijack your computer," C
er Story, July 17). The article is tendenti
sensationalizing, and grossly unbalan
Direct Revenue adheres to the follow
fundamental principles: 1) Consumer c
sent: We obtain explicit consent fi
users prior to installation, and we tell
user—in plain English—that the softw
they are downloading is advertising-s
ported; 2) Easy removal: Our softwar
listed in Add/Remove programs,
every advertisement we display commu
cates this fact to the user and provid
link to uninstall; 3) We collect no pers
ally identifiable information from com
er users. Moreover, Direct Revenue
member of the Network Advertising
tiative, which has pledged to adher
TRUSTe's proposed adware guideli
and has long upheld the standards of
proposed federal legislation of the inc
try, HR 2929, even though Congress
not yet enacted the bill into law.

Elgin fails to disclose that his few
the-record "experts" stand to gain by
icizing Direct Revenue. For exam
Benjamin Edelman—whose recent c
action against Yahoo! Inc. has been
beled a "shakedown for cash" by cy
law expert Eric Goldman—worked
plaintiff's counsel in private litiga
against Direct Revenue.

Finally, the article fails to cite d
mentation that offers a refutation of
York State Attorney General E
Spitzer's allegations.

–Mike Spi
Direct Reve
New

Editor's note: Feedback, a sample of b
nessweek.com reader reaction to "
plot to hijack your computer," appear
page 82.

LESMEN: LESSONS OM THE FIELD

"DEATH OF A pushy salesman" (The rporation, July 3): Selling is indeed go- through a revolution, but I wonder if e results justify the time and expense of ot of "empathy" training—good sales- n are part mavericks and part artists, d I doubt many even understand the aning of the word. What they really ed to know is simple: Listen and deliv- Also, sell the product, but close the rson. I am just a high school graduate t have earned a comfortable living sell- private planes for 37 years with these sic tenets of salesmanship.

–Barron Thomas
Scottsdale, Ariz.

CORRECTIONS & CLARIFICATIONS

In "The godfather of invention" (Cover Story, July 3), Nathan P. Myhrvold's correct date of birth is Aug. 3, 1959.

"The best medical care in the U.S." (Health, July 17) should have stated that most, not all, veterans are eligible for free or low-cost care. In 2003 income eligibility thresholds were instituted for some categories of veterans.

The table accompanying "Where the market will be by 2007" (Personal Finance, July 17) incorrectly stated the asset allocation mix recommended by Barry Freeman, a strategist at HPC Capital Management. Freeman recommends that investors allocate 40% of their portfolios to bonds, not international equities.

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Deconstructing Disease

DR. LEROY HOOD HAS a vision of health care in which physicians predict who will develop certain diseases, and then tailor individual drug regimens to cure them. Doctors will have a vast tool kit of tests that will do more than pinpoint disease-causing genes; they'll decode the intricate chemical signals that pass among the DNA, RNA, proteins, and each cell of the body. Solve such puzzles and you could create health-care blueprints to keep people disease-free well into old age.

Hood is the godfather of this emerging branch of science, called systems biology. The key idea is that the human genome is merely a parts list. To understand the disease process, Hood believes, scientists must decode the complex biochemical pathways created by the more than 50,000 proteins that genes produce—and link what they learn to the whole system. Only then can doctors figure out how to interfere with a pathway to cure or even prevent an illness.

Hood, whose father was an electrical engineer, compares the challenge to figuring out how a transistor radio works: The separate parts aren't very telling until you see how they're assembled into electronic circuits. "When you do that, you understand how radio waves convert to sound waves," says Hood, 67.

Building complete disease models wouldn't be possible without Hood's own inventions. In the early 1980s, he developed a sequencing machine that was later used to map the human genome. He also figured out how to automate the process of synthesizing and sequencing proteins. In 1981, he founded Applied Biosystems Group to commercialize his inventions, and it's still a leading provider of DNA analysis technology, with nearly $2 billion in annual sales.

Hood is known for taking a cross-disciplinary approach to tackling diseases. In 2000 he co-founded the Institute for Systems Biology in Seattle, where 180 specialists in biology, chemistry, math, and physics work together to unlock a ra of medical mysteries, from how cancer develops to how th immune system forms in childhood. Hood was one of the f scientists to clone the gene that causes mad cow disease, a now the institute is working on a blood test that could be used on live animals. "We hope ultimately to detect the disease very early and halt it," he says.

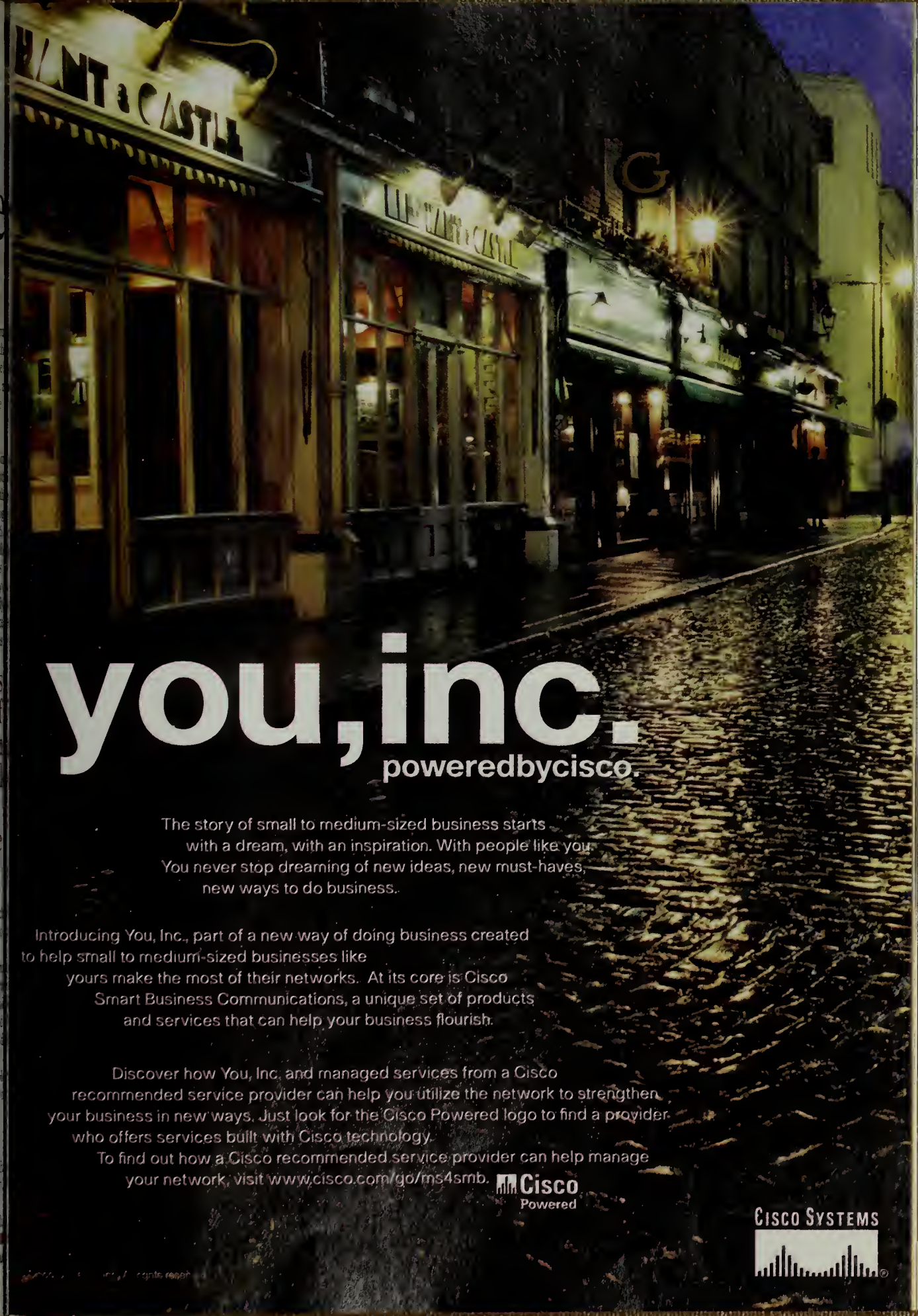
Hood fell in love with biology as a high school student in Shelby, Mont., where he was a star quarterback on the footl team. His science teacher spotted talent in Hood beyond th gridiron and recruited him to help teach sophomore biolog "I taught out of *Scientific American*," Hood recalls. In 1956, brought in an article about th structure of DNA—he was as blown away by the discovery his students were. After study science at California Institute Technology, Hood earned his

> The genome is merely a list of parts. Decodin the way it work is the key to curing disease

M.D. from Johns Hopkins Sch of Medicine, then returned to Caltech to obtain a PhD in biochemistry. Now, Caltech ha teamed up with Hood's instit to form the Nanosystems Biol Cancer Center, which is pursuing "predictive, personalized medicine," says the director, James R. Heath; Hood "sees t future and acts on it."

Big Pharma has yet to catch the systems biology bug. H says most drug-company labs still practice the one-gene, c protein method of chasing down diseases. "They divide science into silos," with the chemists often working separately from the biologists. To encourage more collaboration, Hood's institute developed software tools th he says can get any systems biology lab up and running. "I policy is open-source," Hood explains. "Anyone can download [the tools]." That's just one device he uses to sh biology's focus from the minutiae to systems as a whole.

–By Arlene Weintrau



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BY STEPHEN H. WILDSTROM

Toshiba Jumps the Gun

It's a little hard to call the new Toshiba Qosmio a laptop since the 10-pound-plus behemoth with a 17-inch widescreen is unlikely to spend muc time on anyone's lap. This is the first computer to sport a high-definition DVD drive, and I found it to be a top-flight entertainment system in a luggable package. My only warning: Don't buy it for HD-DVD.

QOSMIO G35-AV650

Toshiba is the leading promoter of HD-DVD—one of two competing formats for high-definition discs—so the company rushed to add HD movie capability to its flagship laptops. (Sony, sponsor of the rival Blu-ray Disc, will similarly equip its top-of-the-line Vaio AR.) The sad fact is, these two HD standards are incompatible, and only a handful of movies are available for either one of them.

Setting aside the issue of high definition for a moment, the $3,000 Qosmio is an attractive choice if you are looking for a compact system that can handle a full range of Windows chores while also functioning as a TV set, movie player, and audio system. The Qosmio has the highest-quality audio that I have encountered on a laptop, with excellent simulated surround-sound using Dolby Laboratories technology. The video system produces gorgeous high-resolution images on the laptop screen, or on a high-definition TV set when hooked up using a special cable. (Ask for an HDMI cable—don't worry what the letters stand for.) The Qosmio is capable of showing maximum resolution HDTV on either built-in or external displays.

FOR ALL ITS ATTRACTIVE FEATURES, however, the Qosmio also shows the big weakness of PCs in home entertainment: The technology is both too complex and too immature for the world of consumer electronics. The Qosmio comes with Windows XP Media Center Edition, which lets it function as a TV set with its own video recorder and 200 gigabytes of disk space to store recordings. You can connect the Qosmio to a cable set-top box, but you can't watch or record high-definition channels. Next year's Vista edition of Windows is supposed to fix this by letting a PC act as its own set-top box. But you probably won't be able to retrofit the feature to current hardware like the Qosmio.

My frustrations with the HD-DVD drive were even worse. The high point of my viewing experience was watching a demo disc of high-def trailers and movie snippets supplied by Toshiba. On both the laptop display and a big HDTV, image quality is vastly better than regular DVD even though the Qosmio does a great jo enhancing the quality of standard discs.

But when I popped the HD-DVD vers of *GoodFellas* into the drive, it wouldn't play. Eventually, I was able to get a pict but no menus and no sound. The disc formats are not really standardized yet, and, according to Toshiba, the player software is being updated monthly. The next version will work with the recently released *GoodFellas*, Toshiba claims. Bu fine print in Qosmio's specifications wa that the player may not work at all with future HD-DVD releases. Similar caveats apply to Sony's Blu-ray Vaio an Toshiba's $500 stand-alone HI DVD player.

HD-DVD is still prone to glitches, leaving some new discs unplayable

Toshiba clearly rushed out b an HD-DVD-equipped laptop a the standalone player in an eff to beat Sony to the punch. Whatever corporate imperative that served, releasing systems t don't work harms the consume True, you have the choice of buying the $2,400 Qosmio G3 AV600, which lacks the HD dri But if you go this route, you wi also have to accept a slower processor, less capable graphi and smaller disc drives.

If you limit your expectations to what the more expensi Qosmio does well, including letting you enjoy standard or downloaded TV, regular DVDs, home photos, or music, it's terrific PC with an outstanding display and audio system. don't get your hopes up about next-generation DVDs. ■

E-mail: techandyou@businessweek.

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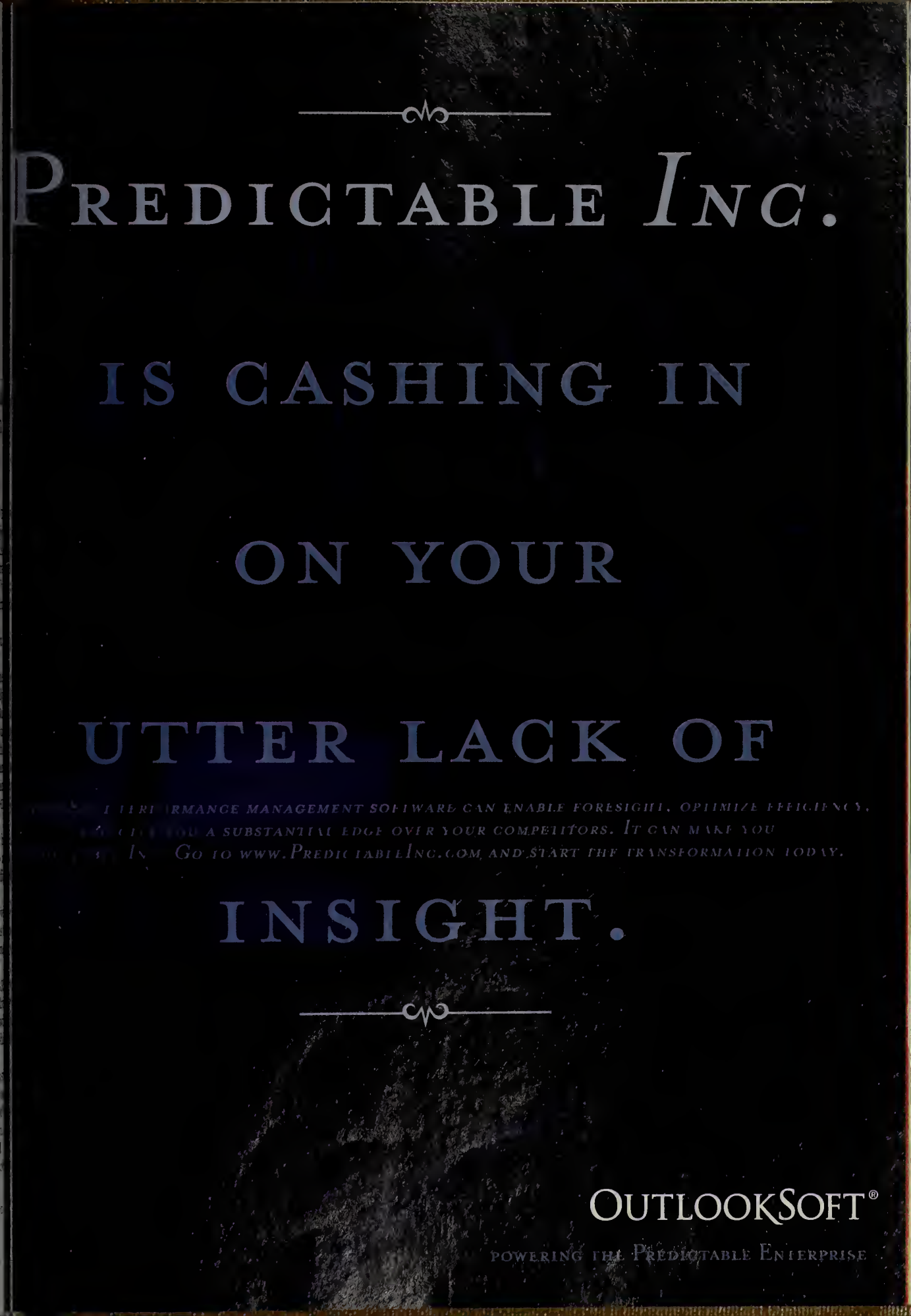
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MediaCentric

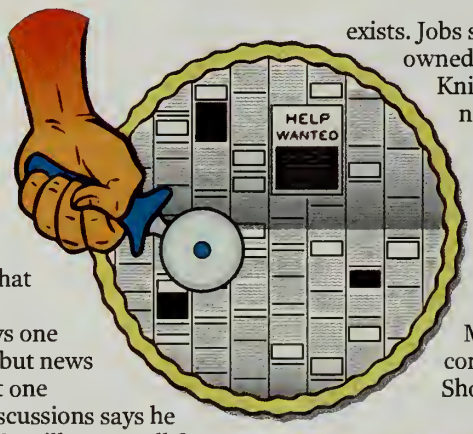
BY JON FINE

Media, Marketing, and Advertising in the 21st Century

Dailies Strike Back at Web

Major newspaper companies and three online giants are deep in discussi about the future of newspapers on the Web. ¶ Yahoo! and a loose consortium of newspaper publishers are mulling a partnership that woul encompass Web classifieds, local news, and content packages based on general themes, like travel. This could drive more traffic to Yahoo's help-

wanted site HotJobs, which trails its key competitors, and bolster future Yahoo moves into local offerings. Newspaper companies would build a network within what is one of the Web's top destinations and win a crucial concession in today's search-engine economy: getting a cut of the ads sold around search results of their content. It's a sore spot for publishers that this doesn't happen now.



"Help-wanted is the quick cash," says one executive involved in the discussions, "but news search is the long-term future." At least one newspaper executive involved in the discussions says he nurses hopes that Web surfers eventually will pay small fees—micropayments, in Web parlance—for some newspaper content. And there's a push to get the newspapers an equity stake in the venture. But another newspaper executive who is familiar with the negotiations says the focus is on more immediate concerns. "In a more search-centric world, how do you guarantee better distribution?" he asks. "That's what a number of these talks are about."

SPEARHEADING THE DISCUSSIONS—though by no means the only participants—are executives from Hearst Newspapers and MediaNews Group, both of which run daily papers near Yahoo's Sunnyvale (Calif.) headquarters. (MediaNews owns the *San Jose Mercury News* and other area dailies; Hearst publishes the *San Francisco Chronicle*.) In a previous interview, MediaNews Group Chairman and CEO W. Dean Singleton hinted broadly at the contours of the companies' thinking without divulging any specifics. "The industry needs to come together to find a search-engine model so that we begin to monetize news," he said recently. Singleton added that related discussions were active "on several fronts." The Yahoo talks began last October. Another company involved in early overtures to Yahoo, executives say, was McClatchy Co., but its recent purchase of Knight Ridder curtailed its involvement.

If the notion of newspaper companies creating an online classifieds network sounds familiar, it's because one already exists. Jobs site CareerBuilder was founded and is owned by Tribune, Gannett, and the just-sold Knight Ridder. It may sound like the new network is gunning for them, but the companies talking to Yahoo are having similar discussions with CareerBuilder and employment site Monster.com. (The recent strong traffic growth at CareerBuilder may be piquing Monste and HotJobs' interest in partnering wit newspapers.) Monster, Yahoo, Hearst, McClatchy, and CareerBuilder declined t comment or did not return calls.

Should a deal get done, it would would be t newspaper companies' bold attempt yet to make more money from their offerings the Web, which have been slammed by competition fro everyone from cars.com to craigslist. The discussions suggest a surprising level of next-generation thinking an an openness to new approac by a medium that has rarely been accused of either.

This just in: Newspapers and Yahoo! in talks to reslice the ad pie

The situation remains fluid and complex. The many parties and potential partnerships involved make the tall resemble an ever-shifting game of three-dimensional che Cynics may sense in all this maneuvering echoes of the il fated New Century Network, a mid-1990s attempt by newspaper companies to create joint businesses on the Internet. That effort was done in by a failure to bridge conflicting interests, among other things. But in 2006, online competition for newspapers' readers and advertisi dollars is no longer theoretical. It's a fact of life, as are fla revenues and shrinking stock prices. And potential partn for those looking to spur significant change are in place. Meanwhile, of course, the clock is ticking. ■

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JAMES C. COOPER

Working Stiffs Have More to Cheer About

ghter job markets are boosting their incomes, but profits could take a hit

U.S. ECONOMY How much more productivity can American businesses squeeze from their operations? Based on the June report om the labor markets, the best efficiency gains for this business cle may be history. If that's true, you can bet that the profits boom of cent years will be winding down sharply in the coming year. But at same time, consumers might actually benefit. It's all result of tight labor markets, which could be even er than implied by the tepid gains in payroll jobs over past three months.

Companies have been ultraconservative in their hiring ompared to past business cycles. The recovery of job wth to its pre-recession peak took much longer than ne jobless recovery after the 1990-91 recession. A ibination of new technologies, competition, and amlined management practices reduced the need for ly new hires and helped to boost productivity growth l beyond its long-term trend, and profits have soared record share of national income. But that was when or markets were looser, and businesses could easily all the labor they needed.

Now the table is starting to turn. Businesses need more kers to meet demand, and they are paying more to act them. The most efficient workers already have , and less-efficient first-time entrants into the labor e, especially younger workers, are looking for jobs in er numbers. Reports of labor shortages at certain led positions are common. The unemployment rate, % in June, is the lowest in five years, and despite the nt slowdown in payroll growth, it will most likely t lower in the second half of the year.

As a result, productivity is slowing and labor costs are ding up, on top of the surge in energy costs. Hourly nings of production workers are growing at an ever- er rate. In June they were up 3.9% over the past year, a five-year high. Profit margins seem likely to shrink, ch will slow overall earnings growth. But meanwhile, useholds are enjoying more income from their labors. l that's a key reason why consumer spending, while ver last quarter, is not about to collapse.

IS IS NOT THE SAME labor market as a decade ago, en the jobless rate was this low. Globalization and sourcing remain a fact of life, but world markets are ch tighter now than in the late 1990s after the Asian rency implosion, and Japan and Europe are stronger, . Global markets offer less of a safety valve for the wing pressures on the U.S.

Most of the attention on the June employment report was directed at the smaller-than-expected rise in payrolls, which increased by 121,000, after disappointing gains in both April and May. But the more interesting number was the 0.4% monthly rise in overall hours worked. For the quarter, hours increased at a sturdy 2.3% annual rate from the first quarter.

Given that productivity is defined as output per hour worked, the hours increase leaves little room for any significant growth in productivity. Even if gross domestic product last quarter grew in the neighborhood of 3%, which is close to the current expectation, productivity would struggle to rise 1%.

STILL PLENTY OF JOBS OUT THERE

Data: Bureau of Labor Statistics, Global Insight Inc.

Coming at a time when labor compensation is picking up, that slim gain means businesses either have to absorb the higher costs in their profit margins or try to lift prices to make up the difference. Up to now, efficiency gains have been large enough to offset rising pay, but that will be more difficult to do in the coming year, as labor markets tighten further.

JOB MARKETS ALSO HAVE CHANGED in that it appears to take even less employment growth now to reduce the jobless rate. As a result, the recent slowing in payroll gains may not necessarily mean either looser job markets or weak consumer spending.

For example, until the past few years, analysis shows that job gains averaging about 150,000 per month were sufficient to absorb new job seekers and hold the unemployment rate steady. However, during the past year, payroll increases have averaged 155,000 per month, and the jobless rate has fallen 0.4 percentage points. In the first half of 2006, growth has slowed to 142,000 per month, and the unemployment rate has continued to drift down, from 4.9% at the end of last year to 4.6% in June.

Despite the payroll slowdown, job openings remain at a high level (chart). Indeed, the Labor Dept.'s Job

Openings & Labor Turnover Survey for May shows that the rate of job openings—calculated as the amount of unfilled jobs relative to overall employment—held at 2.9%, which is the high for the current economic expansion. The rate has been steady at that level all this year. Labor said the industries with the highest job opening rates in May were professional and business services, the leisure and hospitality sector, and education and health services.

ALTHOUGH PAYROLL GAINS eased in recent months, the combination of more work hours and faster growth in hourly pay is translating into solid income growth for households. Multiplying hours times pay, which gives an approximation of household income from wages, shows that second-quarter income rose at a 7% annual rate from the first quarter, following a similar advance in the first quarter from the fourth (chart). This income gauge has not shown back-to-back quarterly gains of that size since the late 1990s, the last time labor markets were this tight.

Part of the smaller payroll gains in recent months might well reflect some temporary uncertainty among companies over how higher interest rates and the spring surge in oil and gasoline prices would affect demand. The fact that businesses still boosted the hours worked by their employees suggests that demand, while constrained, was not severely or permanently damaged.

Clearly, both consumer spending and housing took a hit last quarter, and the softer tone of those two sectors shows up disproportionately in the job data. Overall job growth averaged 108,000 per month last quarter, down from 176,000 in the first quarter. However, jobs in retail trade and residential construction, which are only 14% total payrolls, accounted for 57% of that slowdown.

Elsewhere, job growth and economic activity are holding up well, especially in manufacturing. Factories added 15,000 jobs in June, and they boosted their workweek by 6 minutes, to 41.3 hours. That implies another solid rise in June industrial production. Businesses both at hon and abroad are expanding their operations and their capital spending. Factories are especially benefiting from surging exports, which posted another strong increase in May, helping the non-oil trade deficit to narrow significantly recent months.

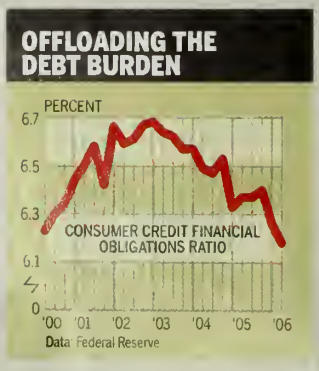
For now, businesses still have abundant profits and a backlog of past efficiencies to use for growing their operations. But every business cycle eventually reaches point where productivity and profits begin to slow and households begin to grab a bigger slice of national income. That moment is getting ever closer now, as lab markets continue to tighten.

CONSUMER DEBT

Paying It Off Is Paying Off

A COMMON CONCERN among economy watchers is Americans' high level of credit-card, auto, and student loan debt. That, along with rising interest rates and energy costs, could put consumers in a perilous financial position. However, solid income gains and some restraint in piling up more debt mean consumers are still in good financial shape.

Look at the the Federal Reserve's latest financial obligations ratio among homeowners covering consumer debt outside of mortgages. This ratio is defined as principal and interest payments as a share of aftertax income, and it fell to 6.18% in the first quarter. That was the lowest since 1998.



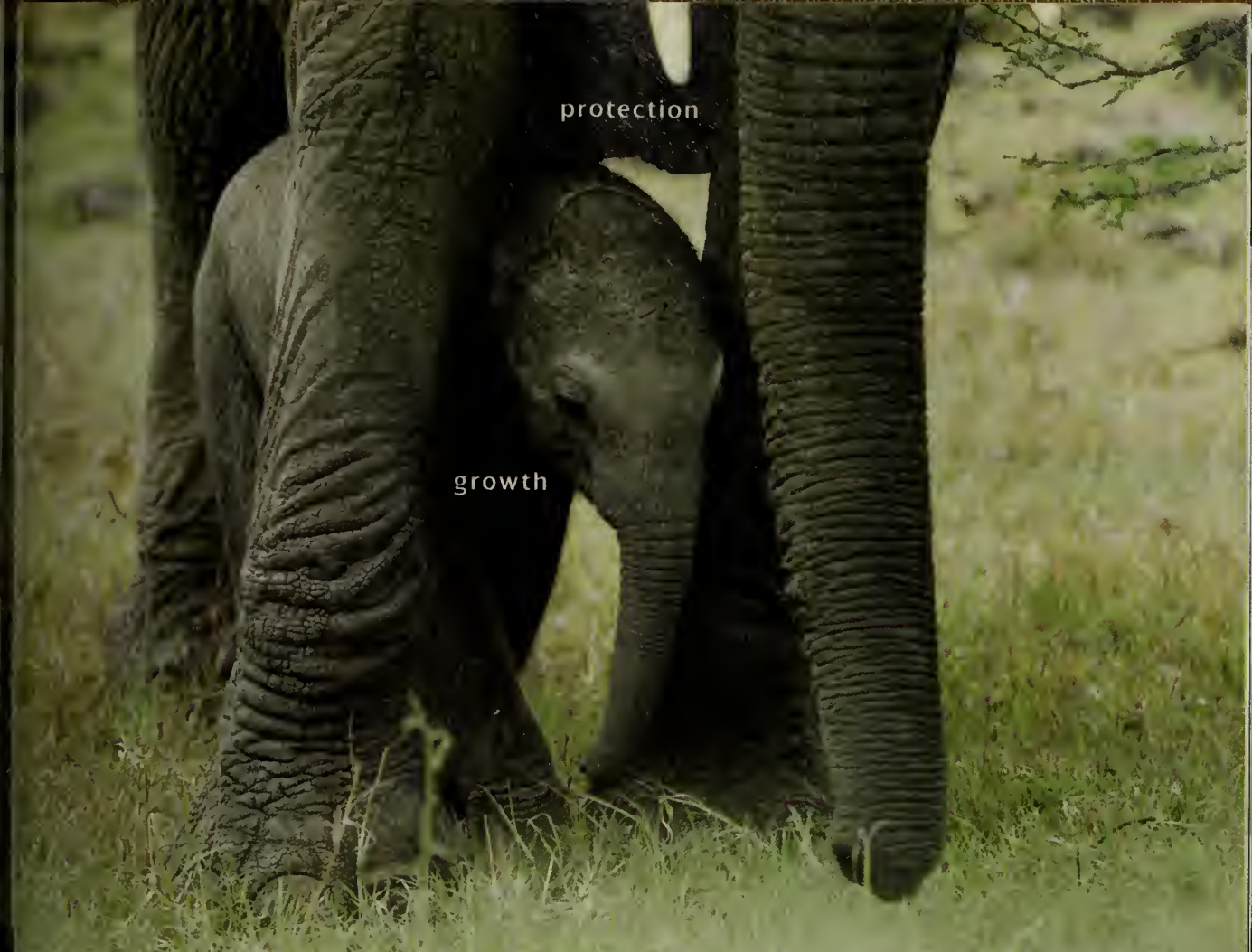
Homeowners have taken advantage of rising home prices by tapping into their home's equity to pay down debts with higher interest rates, such as credit-card bills, as well as to fuel spending. As interest rates rise and refinancing activity dries up, this positive trend should begin to wane.

Even so, the monthly burden of consumer debt is unlikely to turn up sharply in coming quarters. First of all, wages continue to grow at a solid pace, as seen in the June employment report. What's more, consumers are being more cautious when it comes to racking up additional debts. In May, the Fed's measure of consumer installment credit increased 2.8% from a year ago. The recent pace of growth in installment debt is the slowest since the early 1990s.

The positive impacts of stronger wage growth and borrowing restraint also show up in the overa financial obligation ratio among renters. On average, about 70% of renter's financial obligations consi of rent, with the rest consisting of consumer debt. Despite an uptick rents, the ratio's first-quarter consumer debt level dropped to 24.3% of aftertax income, the lowe reading since 1993.

The declining burden of consum debts racked up over the years is g news for consumer spending. For c thing, it lowers exposure to higher interest costs as credit-card rates move up. And with a smaller share income going to pay down consum debt, it also frees up some income t deal with elevated energy costs.

–By James Mehring in New Y



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INST-20051227-A017003

The Business Week

News you need to know

EDITED BY HARRY MAURER

Europe vs. Redmond The **European Commission** stuck it to **Microsoft** on July 12, fining the software maker $356 million for failing to comply with orders to share information about its operating system for servers. What's more, the EU threatened even nastier fines.

Underneath the tough talk, though, signs of reconciliation emerged. **Competition Commissioner Neelie Kroes** praised efforts by Microsoft in recent months to provide data that other companies need to develop programs that mesh smoothly with **Windows.** And while Microsoft is appealing the fine, its top lawyer predicts the company will satisfy EU demands within weeks. Microsoft and European trustbusters still have plenty of issues, such as the company's attempt to overturn a $626 million penalty it drew in 2004 for allegedly abusing its market dominance. But Microsoft may be hoping to tone down the long-running feud before firing up its **Vista** operating system early in 2007. After many embarrassing delays, the last thing Vista needs is another handicap.

ONLINE *See "One more hefty EU fine for Microsoft," www.businessweek.com/go/tbw*

Big Tobacco Wins a Big One A $145 billion judgment against cigarette makers went up in smoke on July 6, when the **Florida Supreme Court** said smokers couldn't sue as a class. Investors immediately lit up the shares of **Altria** and **Reynolds American.** While the legal environment for tobacco is improving, the air hasn't totally cleared—the Florida court also established industry liability, inviting thousands of new lawsuits from individuals.

See "Tobacco may be partying too soon," page 26

The Deficit Dwindles With great fanfare, **Presid George W. Bush** announced on July 11 that the federal def will fall to $296 billion this year, down from $318 billion 2005. Washington had a $236 billion surplus when Bu took office in 2001. After three years of plunging revenu the tax coffers have been filling fast for the past couple years, thanks largely to fatter payments from corporatio But don't celebrate yet: The red ink may start flowi faster again as the economy slows and boomers start c lecting **Social Security** and **Medicare.**

AOL Sheds Its Skin Again Here comes Strategy 2. for AOL, the I-can't-figure-out-what-I-want-to-be-wher grow-up Internet business of **Time Warner.** The media gi said on July 11 that directors will get a plan on Aug. 2 t calls for AOL largely to ditch its subscription business, fering services such as e-mail and instant messaging free in a bid to boost traffic and ad revenues. Since merger with Time Warner in 2001, AOL has vacillated tween identities as an exclusive-content subscription bu ness or a free portal and ad juggernaut. The latest initiat is the brainchild of Time Warner **President Jeffrey Bewkes**

China's Trade Prowess... Those record-setting C nese won't take a rest: The nation's trade surplus hit $1 billion in June, the highest ever recorded by any coun Despite swelling imports, up 19%, to $66.8 billion, expo grew even faster, jumping 23%, to $81.3 billion. Th sure to aggravate trade frictions with the U.S., wh deficit with China also set a record of $202 billion last ye

See "The world against the yuan?" pag

...And a Milestone in the U.S. Chinese carmaker N **jing Automotive** apparently isn't fazed by the jokes about newly acquired British sports car brand **MG:** "Two guys an MG were arrested last night in London following push-by shooting incident." The company said on July that it'll begin building MGs in **Ardmore, Okla.,** in 2008 an effort to reincarnate the marque. Nanjing will also h plants in **China** and **England** and will spend $2 billion on venture. If all goes as planned, it would become the f Chinese car company to manufacture on American s The plant will employ 500. Nanjing bought the remna of MG Rover last year.

Exodus at eBay What am I bid for a former eBay h cho? The latest one available is **Jeff Jordan,** who will dep this fall as president of **PayPal,** eBay's online payme unit, to spend more time with family. The latest in a se of executive exits since early 2005 knocked 5% off eB stock when it was revealed on July 6, leaving shares do 40% for the year. Insiders say Jordan was a candidate the top job, but **CEO Meg Whitman** tells *BusinessWeek:* have no plans to leave eBay."

Your Ad Rated Here As digital videorecorders proli ate, more TV viewers are using them to zap commerci

ers avoid ads the old-fashioned way, by heading to the igerator. So is anybody watching them? **Nielsen Media earch** plans to find out and will start releasing commer- ratings in November, *The Wall Street Journal* reported uly 11. The new service comes as marketers push to cut s because of ad zappers, while network executives nt to the hefty audiences that still watch their shows. sales so far for the coming TV season are off slightly.

n He Electrify RadioShack? You don't need a kie-talkie to know that RadioShack got a rare bit of d news this week. The July 7 announcement that retail eran **Julian Day** will run the electronics emporium rked its shares from 13.73 to 17, adding $442 million to cket cap. Day has a turnaround track record, most re- tly as head of **Kmart,** but he'll need powerful juju at lioShack. Among its woes: the former boss's fictional- l résumé, slumping mall traffic, and fast-fading profits.

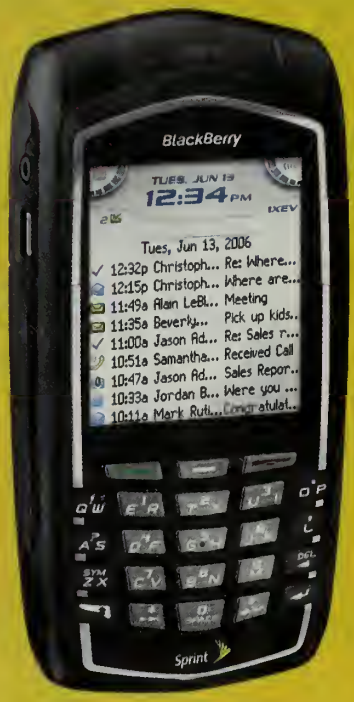
rching Orders for Halliburton Maybe it was just good to last. The **U.S. Army** confirmed on July 12 that it no longer solely rely on Halliburton subsidiary **Kellogg, wn & Root** as the caretaker of troops abroad. Pentagon cials plan to split the logistics contract, under which liburton has raked in roughly $15 billion since 2001, ong four vendors, with bidding to begin on July 28. liburton, **Vice-President Dick Cheney's** former employer, ld still win a chunk of the new deal. Army officials say y're happy with Halliburton's services, but **Defense Dept.** litors have questioned $1.2 billion in charges. Halliburton says its work has been "nothing short of amazing" and t opening up the contract for competitive rebidding is a tine Pentagon move.

Hot Ticket of the Week

OHNNY DEPP

A drunken pirate in black mascara has Hollywood doing a jig. The record weekend opening of **Disney's** *Pirates of the Caribbean: Dead Man's Chest* helped push box office receipts 6.8% ahead of last year, according to tracking firm **Exhibitor Relations.** More important, attendance, which had fallen for three straight ears, is up nearly 4% this year as hot flicks like Disney's *ars* and **Sony's** *The Da Vinci Code* have pulled folks way from video games, the boob tube, and the Net. **ohnny Depp's** swaggering performance gave studios eir eighth straight weekend where ticket sales sur- assed a year earlier, says Exhibitor Relations **President aul Dergaradebian,** "a world apart from where we were a ear ago" when the box office was down for 19 straight eekends. Still, ticket sales are trailing 2004, when round-the-block lines greeted films such as *Shrek 2*, *oider-Man 2*, and *The Passion of the Christ*. The suits ho run the studios had better hope Captain Jack Spar- ow brought some friends to the party.

Spend more time not wasting it.



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LITIGATION

TOBACCO MAY BE PARTYING TOO SOON

It won big in Florida. But huge lawsuits remain, and legal action is revving up around the globe

BY LORRAINE WOELLERT

ONLY A DECADE AGO the tobacco industry seemed untouchable. It intimidated politicians, won every case filed against it, and wowed investors with awesome financial performance. Then a surge of lawsuits hit—the so-called Third Wave of litigation—that toppled Big Tobacco's defenses, ended cigarette makers' long history of mutual cooperation, subjected them to once-unthinkable levels of regulation, stalled their stocks, and sent reverberations throughout American politics and culture. It was one of the most important chapters in U.S. business history.

With the Florida Supreme Court's final dismissal on July 6 of the *Engle* class action, the last major Third Wave case threatening the industry, the tide appears to have subsided. Tobacco executives can barely hide their exhilaration. "The trends are incredibly favorable," said Martin L. Holton III, deputy general counsel for R.J. Reynolds Tobacco.

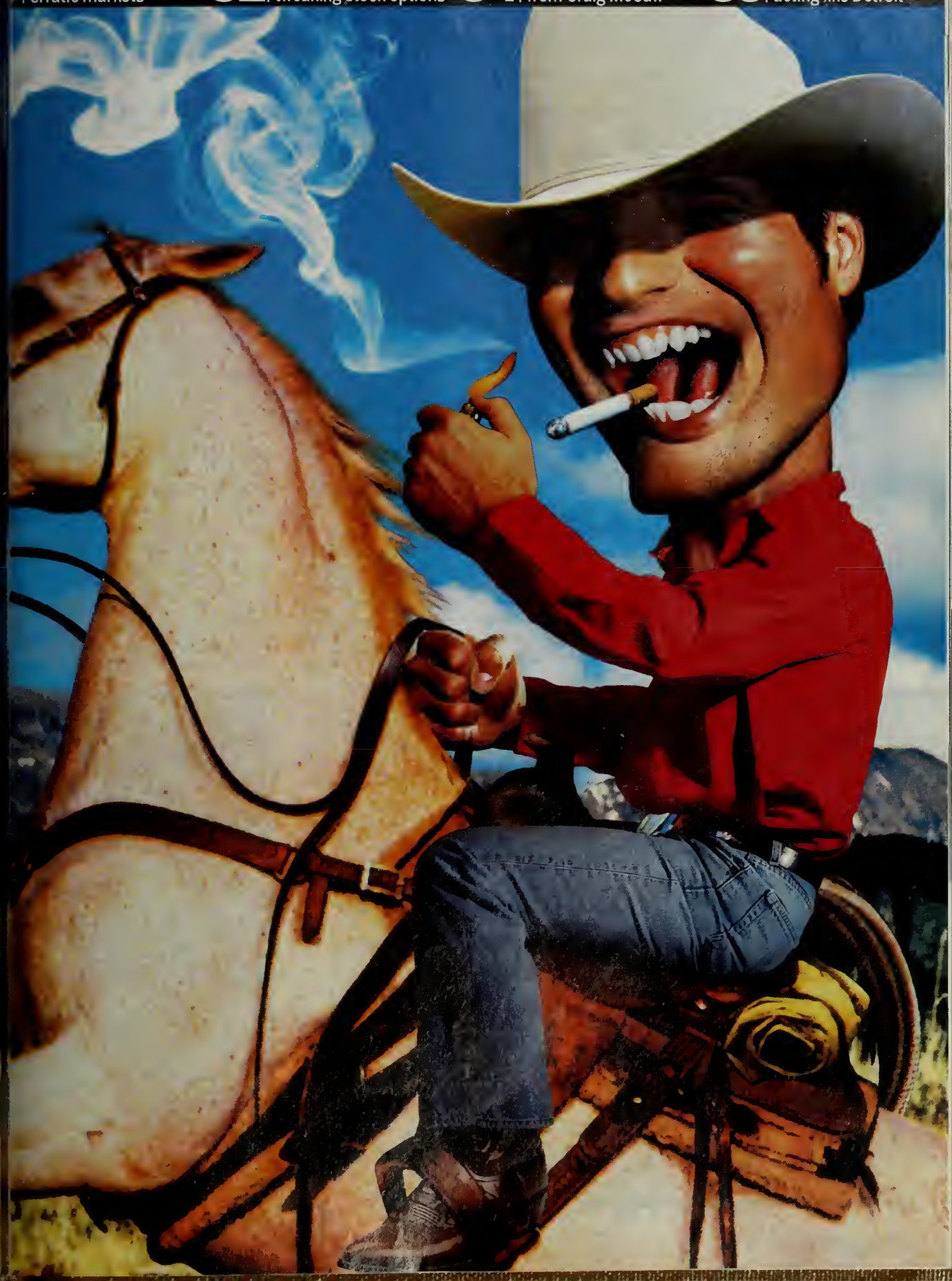
To a certain extent, he's right. It doesn't appear as if suits filed by individual smokers against cigarette makers will ever become big business for the plaintiffs' bar. Defendants are winning most of these cases, and the number of such claims is down from 5,047 in 2000 to 4,068 in 2006. The class-action picture is also brighter, in part because state and federal judges have been reluctant to bundle the health claims of people who may have smoked different products for varying lengths of time while enduring diverging maladies. The number of class actions on file against R.J. Reynolds, for instance, has fallen from 41 in 2000 to 21 today.

At the same time, tobacco companies have launched massive PR campaigns to boost their images. Journalists and politicians no longer get much of a reaction from the public by attacking cigarette makers. And share prices are starting to perk up. As recently as March, 2003, the average price-earnings ratio for companies in the Standard & Poor's 500-stock index was 30.18, nearly five times Altria's 6.51. Today the gap has gotten much smaller, with S&P 500 compa-

EDDIE GUY

IN THIS SECTION:

These traders love erratic markets **32** How companies are tweaking stock options **34** A wake-up call from Craig McCaw **35** Homebuilders start acting like Detroit



nies at 17 times estimated 2006 earnings to Altria's 14.04.

So the Marlboro Man should have plenty of reason to cheer. Altria, Reynolds American, Loews, and other major manufacturers appear to have a chance to reenter the community of respectable American businesses. Can they start acting like normal businesses that are free to make strategic moves, such as spin-offs, without triggering a barrage of lawsuits? Will analysts, journalists, and investors ever be able to discuss Big Tobacco without referring to litigation?

Well, not so fast. True, the *Engle* class action has been eliminated as a $145 billion threat, but the Florida high court's decision still allows individual lawsuits by customers alleging that they were harmed by cigarettes. That could cost hundreds of millions annually. The industry also faces a giant, if largely unheralded, potential class action before maverick federal judge Jack B. Weinstein (below), based on claims that companies misled consumers about the dangers of low-tar smokes. New cases are sprouting up across the globe, which could put a damper on profits in rapidly growing international markets.

COUNTRIES that back the World Health Organization's call for litigation and taxes to curb global cigarette sales

And while Big Tobacco is starting to dig its way out of the hole, it's a deep one. The overall level of litigation is still high enough to alarm investors, who are unlikely to buy the industry's arguments that legal expenses should be treated as ordinary costs of business, like rent. That means a "litigation discount" in tobacco shares is likely to endure. It also suggests that Altria's plan to complete the spin-off of Kraft Foods Inc., which was supposed to be a sure thing if the *Engle* class action got dismissed, might be susceptible to challenge in the courts. Here's how things look on the key legal battlefronts:

"LIGHTS" CASES: The biggest remaining courtroom threat probably is a series of class actions in which smokers argue that they were deceived by false advertising into believing they were better off smoking low-tar "light" smokes than regular cigarettes when the companies allegedly knew they weren't. Big Tobacco has fended off most of these cases, but it faces a potentially huge challenge in the Brooklyn courtroom of Judge Weinstein, wh plaintiffs are seeking damages of $ billion. This is one of the few remain cases where market-shaking, *Engle*-s 12-figure damages awards are theoreti ly possible (if unlikely).

JUSTICE DEPT. LAWSUIT: The other co room drama that potentially could duce a big judgment stems from the tice Dept.'s landmark case against industry. In 1999 the agency sued to cover billions of taxpayer dollars spen Medicare and other federal program care for sick smokers. Tobacco ducked biggest legal threat in 2005 when Jus backed off its original demands manufacturers cough up some $280 lion in allegedly ill-gotten gains. But arette makers could still be liable for billion—$10 billion over five years to smokers quit and $4 billion over 10 y to finance a federal anti-smoking c paign. A verdict from U.S. District C Judge Gladys Kessler is expected by summer or fall.

SECONDHAND SMOKE: Lawsuits by n smokers got a big lift on June 27, w Surgeon General Dr. Richard H. Carm released a 670-page study that found any exposure to secondhand smok risky. Expect to see more cases base such claims. Until now these laws which started surfacing in the late 19 haven't gained much traction. In 1997 industry reached a deal in a Miami c

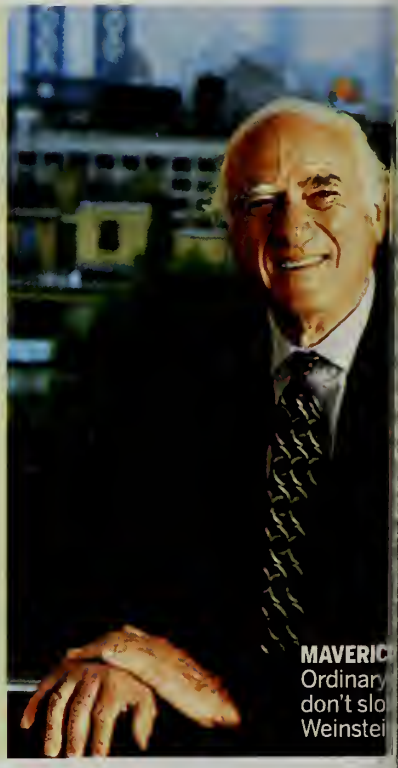
CLASS ACTIONS

A Wild Card Named Weinstein

BY JANE SASSEEN

The biggest thing that Big Tobacco fears is fear itself—specifically, the terror that grips investors contemplating the barrage of lawsuits against the industry. For the past decade, cigarette executives have been trying to convince Wall Street that their legal expenses are predictable and manageable. But every time they appear to be on the verge of succeeding, a new courtroom threat chills the markets.

Now tobacco companies are coming off their most important legal victory in years, the dismissal of the so-called Engle class action in Florida. Yet they may still have a hard time calming nervous investors. One big reason: an 84-year-old federal judge in Brooklyn, N.Y., named Jack B. Weinstein. The very definition of a judicial maverick, he likes big class actions. He has presided over controversial cases involving everything from asbestos to Agent Orange. Up next on his docket: a decision on whether to green-light a class action potentially covering tens of millions of people who bought "light" cigarettes dating as far back as 1971. Plaintiffs' lawyers claim smokers were defrauded because the cigarettes were no safer than regular smokes and manufacturers knew it. They're seeking damages that, at least by their calculations, could hit $40 billion—and



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(TOP TO BOTTOM) INDEX STOCK; AP/WIDE WORLD

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ms have been dismissed
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0 remain. In 2002 a
awarded $5.5 million
damages in tobacco's
losing secondhand-
ke case. A judge later
uced that amount to
0,000. Another case
ed in a mistrial, and defendants have
six others.

BAL: Even as the number of U.S. law-
s shrinks, the industry is facing a
nacing wave of litigation worldwide.
May, British Columbia's high court up-
d class certification in a case alleging
t Imperial Tobacco Canada deceptive-
abeled its cigarettes as "light" and
ild." Canada's provinces last year also
a green light to sue companies to re-
er the cost of caring for sick smokers.

TOBACCO'S FORTUNES

Individual claims are declining...

NUMBER OF CLAIMS

...as are Altria's legal costs*

MILLIONS OF DOLLARS

But potential liability remains high as industry appeals lost jury verdicts:

TOTAL PUNITIVE DAMAGES AWARDED TO DATE..... **$34.2 BILLION**

TOTAL PUNITIVE DAMAGES PAID SO FAR..... **$206.5 MILLION**

And more countries are jumping on the litigation bandwagon:

COUNTRIES WITH TOBACCO LAWSUITS PENDING, 2000..... **12**

COUNTRIES WITH TOBACCO LAWSUITS PENDING, 2005..... **35**

*DEFENSE COSTS IN PRODUCT-LIABILITY CASES. OVERALL INDUSTRY FIGURES NOT AVAILABLE

Data: American Cancer Society, Tobacco Products Liability Project, World Health Organization Tobacco Free Initiative, and industry reports

"They've taken the theories we've developed here and are using them in Canada," says Stephen A. Sheller, managing partner at Philadelphia law firm Sheller Ludwig & Badey. France, Israel, Spain, and other nations also are suing to recoup health costs.

Law enforcement agencies in some countries, including Canada and Colombia, are claiming tobacco companies engaged in cigarette smuggling and money laundering. Those governments hope to recover tax revenue lost as a result of smuggling. That's in addition to product-liability cases being filed by thousands of smokers in at least 35 countries, notably Argentina, Brazil, Canada, and Italy. Nonprofit groups also are using the courts to push for policy changes. They've succeeded in India and Uganda, which have imposed strict smoking bans and limitations on cigarette advertising. "I think you'll see more creative use of litigation to change government policy," says Heather Selin, an adviser for the Pan American Health Organization.

Add it all up, and it's clear that Big Tobacco's troubles are far from over. The industry is no longer a favorite punching bag. But litigation is going to be a huge worry long after the Third Wave recedes.

–With Jane Sasseen in New York and Nanette Byrnes in Chapel Hill, N.C.

award would automatically be tripled
ause the suit is being brought under the
keteer Influenced & Corrupt
anizations, or RICO, Act.
t makes little difference that similar claims
e made no headway in a dozen other
rts. Weinstein is a famously independent
ker who has long championed an
ansive approach to class actions as a
edy for large-scale industry wrongdoing.
Aug. 14 he's scheduled to hear oral
uments on whether to certify the "Schwab"
t cigarette class action, named for the lead
ntiff. Most observers expect him to do so.
e combination of cigarettes, class actions,
Judge Weinstein constitutes something of
rfect storm for the tobacco makers," says
athan Turley, a professor at George
shington University Law School.
f Weinstein allows the class action to go
ard, of course, the plaintiffs' attorneys
ld still have to prove their case. And even if
acco makers lose in his court, they could
go to the more conservative Second Circuit
rt of Appeals in New York City—which has

> "The combination of cigarettes, class actions, and Judge Weinstein constitutes something of a perfect storm for the tobacco makers"
>
> *–Jonathan Turley, Professor George Washington University Law School*

reversed many of Weinstein's decisions in past class actions. But these are the kinds of rational legal arguments that, to the frustration of the tobacco industry, fail to mollify investors who worry that the ordinary rules may no longer apply to such a widely vilified industry.

Weinstein happens to be somebody who has never cared that much about the ordinary rules. In his nearly 40 years on the bench, he has developed a reputation as a plaintiff-friendly judge willing to develop novel theories to resolve the complex legal and social issues underlying most mass litigation. In 1999 he presided over the first jury trial ever to find gun manufacturers liable for the way their products are sold. While critics complain that Weinstein often stretches the law, he has repeatedly argued that broad class actions are the most efficient way to force manufacturers to pay up when large numbers of people have been harmed.

That reputation is precisely why the Schwab case ended up in Weinstein's court. While cases are normally assigned randomly to judges within the federal district where they are filed, plaintiffs can ask for a judge who has previously handled related cases. Because of Weinstein's track record, which has included several major tobacco cases, the Schwab case was filed in Brooklyn, and it went to him. "The plaintiffs put this before Judge Weinstein for a reason," says David J. Adelman, an analyst at Morgan Stanley. "He's far more inclined than the typical judge to certify this as a class action."

–With Danna Cook in Brooklyn

INVESTING

RIDING THE ROLLER COASTER

Once niche players, volatility traders are thriving in these gyrating markets

BY JOSEPH WEBER

THE DIZZYING 100-POINT-plus swings in the Dow Jones industrial average over the past few months have been enough to send most investors reaching for the Dramamine. But a few money managers are diving into the choppy markets headlong. Using a slew of complicated options and futures strategies, their goal is to trade the volatility itself.

A few years ago volatility traders were niche players at big banks. Now they're moving to established hedge funds or setting up their own so-called vol funds. The pitch to prospective investors: Volatility should be considered an asset class in itself, like stocks, bonds, or commodities.

Hedge funds, of which volatility funds are a subset, are famous for jumping in and out of markets quickly and aggressively. Most make specialized bets on everything from merger activity to convertible bonds without regard to the overall market's direction. Volatility funds bet purely on swings in volatility. And they live for weeks like June 8-15, when the Standard & Poor's 500-stock index fell nearly 3% in three trading sessions, then gained most of it back in the next two.

Because hedge funds are so secretive, it's hard to count up all the vol funds out there. Fimat, the global brokerage unit of Société Générale Group, tracks 10 of them, aggregating their results into a monthly performance measure called the Fimat Volatility Arbitrage Median. Some 1,800 investors and fund managers subscribe to it, up from 400 when it launched in 2003. The burgeoning market might already be worth $10 billion, say executives at Fimat.

"We're in a period of unusual eco-political uncertainty," says Philip Gotthelf, a longtime metals trader who manages $62 million at Equidex Inc. in Closter, N.J. "The opportunities to profit from volatility have increased." Gotthelf says the accounts he manages have posted 25% to 75% annualized retu in 2006.

In truly tumultuous times, vol trad thrive. The Turtle Fund, one of a gro of funds managing $300 million Britain's Isle of Man, posted a 20.7 gain in 2002, while the S&P 5 thrashed around, finishing the y down 23%. Conversely, serene mark are bad for vol traders. Turtle's retu shrank to between 1.65% and 5.5% year from 2003 to 2005 as volatility to multiyear lows. But through June this year it has returned 5.78%—w 1.84% of that in the erratic month June. The Volatility Arbitrage Med was up 3.41% year to date through Ju nearly twice the S 500's return of 1.76%

Vol traders d mostly in options stock indexes and Chicago Board Optic Exchange's Volati Index, known as VIX or the "fear inde which tallies opt prices to gauge exp tations of near-te volatility. The climbed sharply in recent mon (chart). But while the jump felt drama it was fairly modest compared with trauma of 2000-03. Turtle Fund direc Marco De Franceschini expects mark to get choppier from here. Among ot things, he says, Japan is likely to hike terest rates soon, which may stir markets as much as the Fed's nons hikes have.

Even small traders are getting int ested in volatility. John F. Carter, Austin (Tex.) trader and president o nancial analysis firm Trade The Mark has one account dedicated solely to trading. He says he has increased it fr $50,000 to $86,000 year to date. T May-June flurry was a refreshing turn events, he says. For much of the last c ple of years, investing was "like watch paint dry."

Retail brokerages, meanwhile, repo brisk business in VIX options, launcl by the CBOE in February. "We're seein lot of activity," says Randy Frederick, rector of derivatives at Charles Schwa Co. That's probably a bad thing. VIX tions are highly risky and best left to s ous professionals with fancy compu models, say financial advisers. T again, some investors who have watc their mutual funds gyrate wildly in rec months might think that doing nothin the riskiest strategy of all.

INTERESTING TIMES

Data: Chicago Board Options Exchange Inc.

NO FEAR Carter trades in the volatility market before breakfast

What if everyone just settled for average? What if nobody raised the bar? What if everyone decided to let someone else figure it out? At ConocoPhillips, we're not only finding new resources for natural gas, we're developing new technologies to solve the demanding increase in global energy needs. By investing in Russia's oil and natural gas reserves, the world's second largest, we're helping ensure global energy production for decades to come. Turning "what ifs" into "what's next" — it's what we do every day.

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ACCOUNTING

TA-DA! CHEAPER STOCK OPTIONS!

Companies are tinkering with the formulas they use to value them

BY JANE SASSEEN

NO SURPRISE HERE: AS U.S. companies faced the prospect of having to deduct stock options expenses from their profits starting in 2005, they scrambled to cut their costs. All told, the value of options granted by businesses in the Standard & Poor's 500-stock index has tumbled, from $104 billion in 2000 to $30 billion in 2005, according to a new report by Credit Suisse Group analyst David Zion.

Much of the drop has been straightforward: Companies have issued fewer options. But plenty have tinkered with the formulas they use to value them. That's possible because the expense recorded for an option is only an estimate based on assumptions about how long the option will be held, how volatile the stock is, and other factors. Come up with more favorable assumptions and the cost of the option declines.

Volatility estimates are the easiest to rework. Options for volatile stocks carry higher expenses, because the added gyrations mean the holder has a better chance of cashing them in for more money. All together, 382 companies in the S&P 500 cut their volatility numbers in 2005, slashing an estimated $4 billion off the aggregate cost of options.

Semiconductor maker Intel Corp. will pocket the biggest gain from the switch. Zion figures that by cutting volatility estimates from 50% to 26%, Intel reduced the price of each option it granted in 2005 by 40%. Apply those savings over the 119 million options it gave out, and he estimates Intel will save $519 million over the options' vesting period. The key question, says Zion, is whether the lower estimates are more accurate or simply more aggressive.

No doubt, some of both. Stocks in recent years have been less volatile t they were during the boom, so a lo number can make sense. And with the vent of expensing, Intel and others h switched from using historical numb to using "implied" estimates of fu volatility based on the price their opti fetch in the markets. Because of the 20 2006 drop in volatility, the implied n bers have been lower than the histo ones. Intel and others say implied figures are a bette dicator of the volatility the likely to see ahead.

But are they? Volatili are heading up (page 30). ter bottoming at near 10 December, the Chicago Bo Options Exchange's Volat Index jumped to the low- range in June. Analysts th higher volatility will be h for a while. "We've been r 10-year lows," says ana Chris Senyek at Bear, Ste & Co. "Companies may h made the switch at the w possible time."

That, of course, depend your perspective. At com nies where volatility numb have been notched down far, the cost of options d out in 2005 has effecti been lowballed.

An honest mistake, haps. It's still early in the tions-expensing era. Bu volatility continues to warns Zion, that fact have to be reflected in year's estimates, driving options costs and weigh on earnings in the future.

–With Greg Ha in New

Rosy Assumptions

By slashing the volatility estimates used to calculate the value of the options it grants, a company can sharply reduce the expense of those options, lifting profits. Here are the companies that will benefit most from the practice:

	Estimated Volatility Used to Set Options Price* 2004	2005	Estimated Savings in Options Expense Due to Lower Volatility** (In millions of dollars)
INTEL	50%	26%	$519
ANALOG DEVICES	69.2	27.4	173
BROADCOM	64.0	40.0	118
QUALCOMM	53.2	36.5	112
YAHOO!	50.0	35.0	101
EBAY	49.0	36.0	96
AMGEN	44.0	23.4	88
HEWLETT-PACKARD	35.0	28.0	73
DELL	43.0	36.0	69
WAL-MART	32.3	23.2	69

* For each fiscal year ** As measured by the estimated reduction in the fair value of options granted in 2005 Data: Credit Suisse Group

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SECOND ACTS

A WAKE-UP CALL FROM CRAIG McCAW

Clearwire's plan to create a mobile broadband network could make waves

BY CLIFF EDWARDS

IMAGINE A FUTURE LIKE THIS: You're on the Acela high-speed train from Boston to Washington and you want to touch base with friends in Beijing and London. You pull out your laptop and moments later are catching up via video link—even as the train thunders along at 150 miles an hour. Later, as you zip past the White House in a cab, you grab the same laptop to catch up on e-mail, then boot up your media player to watch a few minutes of the afternoon ball game of your hometown favorite, the Boston Red Sox.

If Craig O. McCaw gets his way, you'll be able to do all that, and more, in as little as three years' time. McCaw's Clearwire Corp. has amassed enough licensed radio spectrum to create a nationwide, wireless broadband network based on an emerging technology called mobile WiMAX—a powerful cousin of WiFi. Clearwire got a big boost on July 5, when Intel Corp. and Motorola Inc. pumped nearly $900 million into the company. The tech giants aim to turn WiMAX into a mainstream consumer technology and hope to make lots of money selling the chips, laptops, cell phones, and other gear that work with

THE STAT

15.4
MILLION

Projected number of WiMAX customers worldwide by 2010, up from about 23,000 today.

Data: Senza Fili Consulting

Motorola and Intel have pumpe nearly $900 million into Clearwire

McCaw famously ended Ma Bell by build a cellular phone netw in the 1980s, a business later sold to AT&T $11.5 billion. Now could be poised to much the same to toda cable, satellite, and t com players by provid a cheaper alternative the broadband servi they currently offer. "H ing a need that oth aren't addressing has ways been a focus of the companies th have been involved with," McCaw say

Not so long ago, McCaw's WiM gambit seemed less threatening to the trenched players. There were no ind trywide standards for mobile WiMAX the equipment was too expensive to out on a large scale. But last year the dustry adopted the long-awaited st dards, which helped bring Motorola a Intel into the game. Add McCaw's con of one of the biggest chunks of WiM spectrum, and he seems well position

The cable guys and telcos profess the selves unfazed by McCaw's WiMAX an tions. But you can easily imagine pec preferring to subscribe to a Clearwire se ice that allows them online access a where rather than one that restricts th to their home. What's more, beca WiMAX infrastruct is so much cheaper build than traditio networks, Clearv can likely afford to o a nationwide mo service for as little $25 a month. Sudde paying $60 for Veri Wireless' Broadba Access service look lot less attractive.

This is not jus question of luring a rivals' subscribers,

. McCaw's WiMAX play also could in jeopardy the billions of dollars the os and cable companies are investing ake their broadband networks faster more reliable. For example, Verizon ending $20 billion to $40 billion to out fiber-optic lines to homes over the t 10 or so years. Meanwhile, the cellu- carriers have spent comparable unts on so-called 3rd Generation works that are supposed to let sub- bers watch "real-time" TV on their nes, among other things. WiMAX n't necessarily make these invest- nts redundant, but it could provide ugh competition to make it hard for carriers to recoup the billions spent.

FENSIVE MOVES

IS NO ONE STANDING in McCaw's ? Well, some of the key players are ady making moves that could fend off. The cellular carriers are work- with PC makers to extend their adband business beyond phones. siness commuters already are snap- g up new plug-in modem cards that w them to get online anywhere. Ver- n Wireless and its ilk also have been ing prices on both the cards and nthly broadband subscriptions. nd in November, Comcast, Time rner Cable, Cox Communications, l Advance/Newhouse Communica- ns cut a deal with Sprint Nextel Corp., only other company with nation- e WiMAX spectrum. The partner- o allows the cable guys to offer cellu- phone service, key to competing with telcos. But they also could resell int Nextel's WiMAX service or even some of its spectrum. "The [Sprint] l lets cable providers keep their op- ns open as far as wireless goes," says rles S. Golvin, an analyst for For- ter Research Inc. Then again, Clearwire is already ging strategic partnerships of its n. AOL, for example, resells the com- ny's WiMAX service. Meanwhile, ellite provider DirecTV Group Inc. expressed interest in WiMAX as a y to compete with the cable compa- s and telcos. And despite Sprint-Nex- s deal with the cable guys, it would premature to rule out a partnership ween that company and Clearwire. ther can offer complete national cov- ge, so they might be forced into some d of a roaming WiMAX agreement. With his enviable track record, vast ctrum holdings, and now huge war st, McCaw's Second Act is already l under way.

REAL ESTATE

BARGAIN BASEMENTS

To lure buyers, builders try all sorts of come-ons

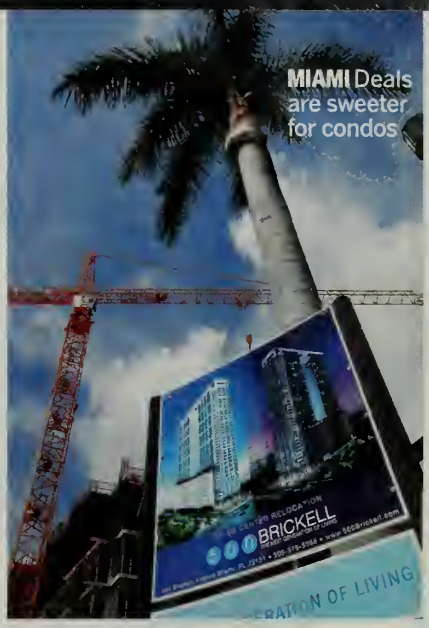
BY CHRISTOPHER PALMERI

IF YOU'RE THINKING OF BUYING a townhouse in the Los Angeles suburb of Alhambra, David Kao would like to talk to you. The salesman for Olson Co. still has 12 units in the Gateway Walk development to sell, even though they've been on the market since February.

He recently began throwing in free kitchen upgrades, which include stainless steel appliances and maple cabinets. Kao is selling a two-bedroom, two-bath townhouse for $499,000, about $50,000 below what the company was getting for similar units last year. He'll even pay the homeowners' association fees for six months, roughly $1,800, or include a free 42-inch plasma-screen TV. "It has been a little slow," Kao says. "Everyone wants a little more."

Facing their toughest year in more than a decade, homebuilders are coming up with a blizzard of incentives to help move houses. They're offering free swimming pools, finished basements, trips to Hawaii, and even luxury cars. Centex Corp. has been cutting prices as much as $100,000 in Northern California. "The new housing industry is taking a page from the automakers," says RL Brown, a Phoenix real estate consultant. "It's a model clearance sale."

Incentives are most prevalent in cities such as Las Vegas, Miami, Phoenix, and Sacramento that have enjoyed the sharpest price appreciation in prior years. The most common is an "interest rate buy-down" in which builders subsidize the early years of a loan.



Shea Homes in Walnut, Calif., for instance, offers a mortgage fixed at 3.99% for five years, about two percentage points below market rates.

HOUSING WATCH

Luring new buyers isn't the only reason builders have embraced giveaways. They're also using incentives to keep existing customers from canceling contracts. It can take six months to deliver a finished house, and builders have traditionally accepted downpayments as low as $2,000. As home prices began to cool, speculators hoping to flip their houses simply cut their losses and ran. To keep customers from bailing out, KB Home is offering rebates of as much as $30,000 on homes they've already sold.

The incentives appear to be working. While still down 5.9% year-over-year, new-home sales were running at a slightly higher rate in May than in April. Still, David F. Seiders, chief economist for the National Association of Home Builders, expects new-home sales to fall about 11%, to 1.14 million, for the year, suggesting things may get worse before they get better. "It's a whole new sales environment out there," says *Builder* magazine editor Boyce Thompson. As the automakers have learned, once you start offering incentives, it's hard to stop.

Garage Sale

With cancelations up and new orders slowing, builders have been lowering prices on new homes

MEDIAN NATIONAL SALES PRICE

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APRIL	$245,900
MAY	$235,300

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NORTH KOREA

LIFELINE FROM CHINA

A visit to bustling Dandong shows why economic sanctions against North Korea may not work

BY MOON IHLWAN AND DEXTER ROBERTS

AFTER NORTH KOREA'S July 4 fireworks—seven missile tests launched toward Japan—it would be easy to assume that the hermit kingdom is more isolated than ever. Don't tell that to the residents of Dandong, a bustling border town in northeastern China.

The city of 800,000, a gritty combination of chaos and glitz, is booming in large part because of thriving trade with North Korea. Streets are lined with small guesthouses catering to North Koreans, while restaurants serve up Korean specialties such as cold noodle soup and spicy kimchi. And just hours after the missiles flew, hundreds of trucks resumed their daily parade across the Friendship Bridge, the main passage over the Yalu River dividing the two countries.

In front of the fortress-like truck inspection station on 10 Wei Rd., florists do a brisk business selling elaborate bouquets to North Koreans seeking to honor Great Leader Kim Il Sung, who died in 1994. But there's more going on than selfless acts of northern nationalism. Across the street, dozens of small shops offer goods ranging from used Sony and Panasonic televisions to gas generators, cooking oil, and toilet paper that truckers and other visitors haul across the river. "The No Koreans who come to China are v rich.... All they use are U.S. dollars," s one shopkeeper. "They buy all of 1 from us, then go back and sell it fo profit in their own country."

The cross-border traffic is just the m visible piece of the strengthening trade between North Korea and its giant nei bor. From 2000 to 2005, North Korean ports from the mainland (including pork, electronic gadgets, and farming m chinery) more than doubled, to $1.1 bill while its exports to China (fish, low-gr

FRIENDSHIP BRID connects two tov with very differer economies

BusinessWeek online For a reporter's notebook describing daily life in Dandong, please visit www.businessweek.com/extras

steel, and minerals) soared more than tenfold, from $37 million to $499 million, according to the Chinese customs office. And by some estimates, informal trade and smuggling could double those figures. Throw in the $715 million in goods shipped from South Korea, about half of which was humanitarian aid such as rice and fertilizer, and North Korea is actually looking less isolated than it has been since its communist trading partners disappeared with the collapse of the Soviet Union.

The growing trade has been a lifeline for the North. Gross domestic product has expanded by about 2% annually since 2000—but without trade and aid from China and the South, the country's economy would have contracted, reckons economist Lee Young Hoon, who monitors North Korea at the Bank of Korea, the South's central bank. "Trade with China won't make North Korea prosper, but it allows Pyongyang to muddle through," Lee says.

Add it all up, and there's little reason to expect U.S.-led economic sanctions against North Korea to work. In an effort to force Pyongyang to abandon its nukes, Washington has tried to block the flow of capital, technology, and goods to the North. But Beijing and ul have opposed such measures. re, there will be lots of harsh rhetoric l talk of punitive action," says Paik k Soon, a North Korea expert at Se- g Institute, an independent think k in Seoul. "But there's no effective ntermeasure unless China and South rea make a strategic decision to let rth Korea collapse."

That's not going to happen anytime n. Neither neighbor wants to see mil- ns of refugees stampeding across the der. Beijing has enough trouble ping its own economy on track and esn't like the possibility of U.S. ops—currently stationed in the ith—sitting right up against its fron- in the event the two countries were reunite. In any case, Seoul wants the North to narrow the huge economic gap between the two before that happens.

China also has more prosaic reasons for encouraging trade. The northeast has been largely left out of China's economic transformation of the past two decades. Lately, though, the region has benefited from a policy letting specially licensed traders in border areas import goods at about half the average duty of 12%, the Bank of Korea says. The reduced tariffs and relative ease of moving goods across the border have prompted North Korean merchants and state-run trading companies to use Dandong and nearby cities as a gateway for their business deals with the rest of the world.

Neon signs and new office towers in a once-sleepy China border town

That has transformed once-sleepy Dandong. New apartment blocks and office towers are rising along the riverfront. A block away from the water, Binjiang Road glows with bright red, yellow, and gold neon signs announcing seedy saunas and crowded pool halls frequented by Chinese, Russian, and North Korean dealmakers.

Across the river, the North Korean city of Sinuiju practically vanishes at night. The waterfront is little more than dilapidated quays, shabby warehouses, a long-idle Ferris wheel, and rusting boats pulled up on the shore. To conserve electricity, typically available for only a few hours a day in much of North Korea, buildings in the city of 350,000 are barely lit at all. The only visible glow comes from an enormous statue of the Dear Leader, the name used for dictator Kim Jong Il. "You can't get lost," says one Dandong native who has been trading over the border since 2000. "Just look for the only light, and that's where you'll find a statue of the leader."

WARNING SHOTS

DESPITE THE GLOOM, trade has injected new life into the North. Recent visitors say once-barren shops are brimming with Chinese-made TVs, refrigerators, bicycles, and other goods. And wholesale markets for raw materials and machinery have been set up in Pyongyang and elsewhere, visitors say. But as economic activity picks up, the shortage of supplies is felt even more acutely. "Every factory wants more raw materials, and the cash-strapped country simply can't meet demand," says Jo Dong Ho, a North Korea expert at the state-funded Korea Development Institute in Seoul, who visited the North in May.

In fact, the missile tests may have been a ploy aimed at breaking a diplomatic impasse that's heightening the financial stress on Kim's regime. North Korea wants China's help in releasing $24 million frozen at Banco Delta Asia, in the Chinese enclave of Macau, following charges last year by the U.S. Treasury Dept. that North Korea used the bank to launder proceeds from counterfeiting U.S. currency and other illegal activities. "The missile tests illustrate that North Korea is unhappy with China," says Yan Xuetong, director of the Institute of International Studies at Tsinghua University in Beijing.

China, in turn, was clearly miffed by the test and dispatched a top envoy to Pyongyang to express its concern. But unhappy enough to stop the flow of trucks across the Friendship Bridge? Unlikely.

OPENING THE HERMIT KINGDOM

Data: Chinese Customs, KOTRA (Korea Trade-Investment Promotion Agency)

CARMAKERS

JAPAN TAKES A NEW BITE OUT OF DETROIT

Denso and others are making serious inroads into the auto parts biz

BY IAN ROWLEY

EVER SINCE AMERICANS began their love affair with Japanese cars four decades ago, General Motors, Ford, and Chrysler have seen their share of the U.S. market tumble. Now those same automakers are starting a romance with a different Japanese industry—parts manufacturing—adding to the woes of troubled U.S. suppliers such as Delphi, Tower Automotive, and Lear.

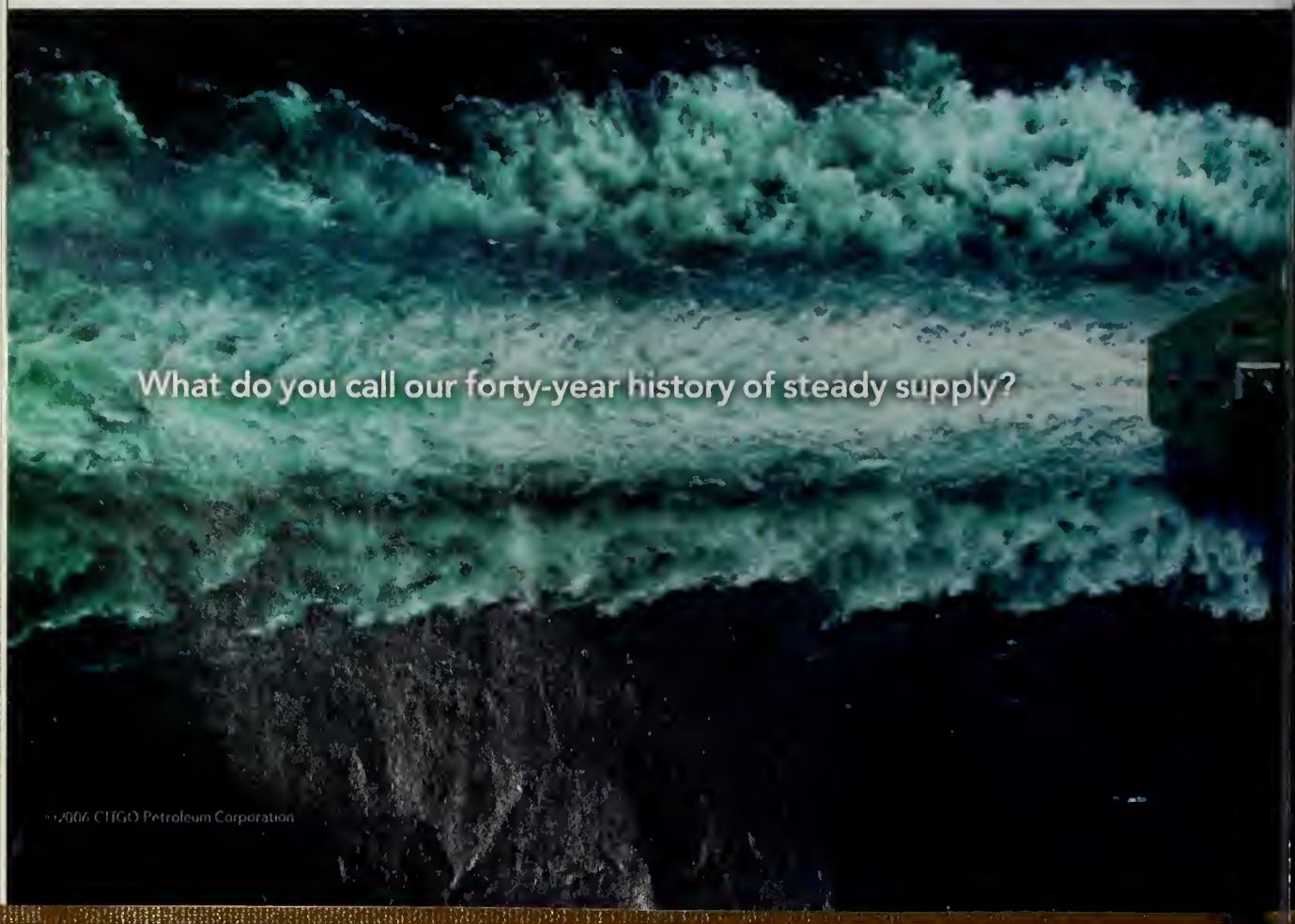
Although Japanese component makers remain largely committed to their home-country partners, growing interest from U.S. manufacturers is boosting sales and profits. All told, Japanese suppliers last year sold $26 billion worth of products in the U.S., giving them about a quarter of the market, brokerage Nikko Citigroup Ltd. estimates. Toyota Motor Corp. affiliate Aisin Seiki Co. saw its North American sales grow 37%, to $2.4 billion, last year, with nearly $1.1 billion of that going to companies other than Toyota. At Denso Corp., another Toyota ally, American sales gr 19%, to $5.9 billion, in the year ende March. That helped Denso post rec earnings of $1.5 billion, compared w the $2 billion operating loss Delphi pects this fiscal year. "We're not fixated size," says Denso President Koi Fukaya. "But we feel our business opp tunities are increasing."

MICHIGAN D factories ar known for c

BURNING RUBBER

DENSO IS CLEARLY the leader. It has U.S. factories, and all three Detroit au makers buy heaters, air condition fuel injection systems, and other com nents from the company. Denso's sale GM have doubled in the past five ye today 40% of its North American bu ness comes from non-Japanese c makers. In April, Bo Andersson, G global vice-president of purchasi named Denso the company's top ven The outfit was "our best supplier ba on timely delivery, quality, and warra costs," Andersson says.

Other Japanese parts makers are try



to follow in Denso's tire tracks. Showa Corp. has plants in Ohio and Canada that make shock absorbers, power steering systems, and other components for Hondas manufactured in the U.S. In January, though, the company started selling propeller shafts to DaimlerChrysler for use in the Dodge Caliber SUV. Now Showa is aiming to wean itself further from Honda Motor Co., which currently accounts for 80% of its business. "We're keen to expand sales with the Big Three," says Shigeru Handa, a manager at Showa.

Part of the reason for the success of Denso and its peers is a change of attitude in Detroit. In years past, the Big Three simply drew up specifications for components and then gave business to the parts maker with the cheapest price. Today, GM is working more closely with suppliers during the development process, and Ford and Chrysler are starting to head in the same direction.

Still, for all the growth, Japanese automakers will likely remain the top priority for these suppliers. For one thing, Japanese manufacturers are continuing to ramp up North American production as quickly as Detroit scales back. And relations with affiliates are deeper than those with the Big Three: Last August, Ford groused that Aisin Seiki favored Toyota when supplying scarce hybrid transmission systems.

THE STAT

$26 BILLION

2005 sales by Japanese auto suppliers in the U.S., representing 25% of the market

Data: Nikko Citigroup

The Japanese are continuing to press their advantage. Just as hefty profits let Japan's carmakers take the lead in safety and environmental technologies, Denso and the others are devoting more money to their own research to stay ahead of the game. "They have excellent product development," says Jeffrey K. Liker, a professor of industrial and operations engineering at the University of Michigan. "My belief is that they are better than their American competition."

–With David Welch in Detroit and Hiroko Tashiro in Tokyo

BRITAIN

HANDCUFFS ACROSS THE WATER

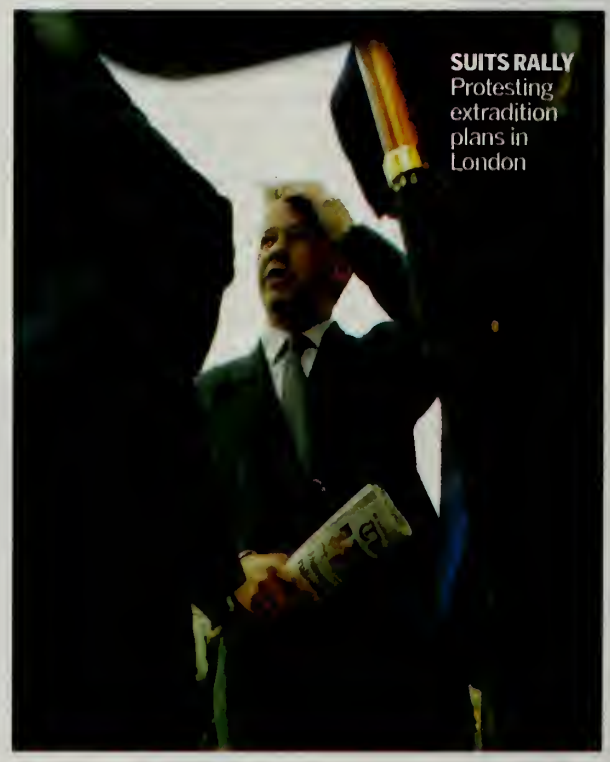
Why a treaty with the U.S. to extradite terror suspects is riling British executives

BY KERRY CAPELL

HERE'S SOMETHING YOU don't see every day: 100 executives in suits and ties assembling for a protest march. But there they were in London's financial district, furious if subdued, at a rally in late June to protest a treaty between the U.S. and Britain. Their beef? They're convinced that the treaty, first trumpeted by British Prime Minister Tony Blair as a way to speed the extradition of terrorism suspects, has been unfairly used against British executives.

The rally came two weeks ahead of the planned July 13 extradition of a trio of former bankers known as the NatWest Three. U.S. prosecutors claim they conspired with Enron executives to defraud their employer, British bank NatWest, of $7.3 million by investing in an Enron offshore partnership. They face legal fees of more than $2 million each and, if convicted, up to 35 years in a Texas jail. If the U.S. Justice Dept. has its way, they will be the first in a long line of white-collar suspects to be sent unwillingly across the Atlantic. Since Britain ratified the treaty in 2004, the U.S. has requested the extradition of 24 Brits wanted for white-collar crimes, but only three who were accused of terrorism.

Few would argue there's anything wrong with going after crooks, white-collar or otherwise. But as Britain Inc. sees it, the treaty has been exploited by an overzealous Justice Dept. In a letter to the British government in early July, GlaxoSmithKline PLC Chairman Christopher Gent, London Stock Exchange Chairman Chris Gibson-Smith, and retail billionaire Philip Green, among others, wrote that the U.S. is using the treaty "not to capture bombers, but to bring to trial in America British businessmen."



SUITS RALLY Protesting extradition plans in London

> The U.S. has used the treaty aggressively to collar white collars

The situation is fast becoming a major political embarrassment for Blair. For starters, only Britain is subject to the requirements of the treaty because the U.S. has yet to ratify it. On July 12, Parliament held an emergency debate on the issue. Hoping to defuse anger at home, London decided to dispatch Home Office Minister Patricia Scotland to Washington to urge the U.S. Senate to ratify the treaty. The Senate Foreign Relatic Committee has scheduled hearings the treaty for July 19, and key senat are pushing for ratification this year.

"UNEVEN PLAYING FIELD"

EVEN IF THE SENATE approves the p the treaty will still be unfair, say legal perts in London. They argue that the b den of proof required by U.S. authoritie order an extradition is much lower t what London must provide Washingto get its hands on an American. The U.S., instance, can extradite British citizens v only a "hearsay affidavit," a sworn st ment from a prosecutor making alle tions, rather than detailed evidence. To tradite a U.S. citizen, Britain must prov evidence of proba cause that will stand u a U.S. court. "It's a v uneven playing field," s Digby Jones, former di tor general of the Conf eration of British Indus

Britain and the U dispute that assessm Both sides say the tre brings the U.S. in with agreements Brit already has with Can and Australia. In a Jul interview with BBC ra the U.S. ambassador London, Robert Tu said the evidence quired to extradite "roughly the same" both countries.

That's scant comfor Ian Norris, the retired of British enginee group Morgan Cruci The Justice Dept. alle that Norris conspired t prices of carbon prod in the 1990s but has provided London with sworn allegations, not hard evide What's more, though a crime in the U price-fixing was not illegal in Britain at time. Alistair Graham, Norris' attor says the case "will test just how far the extradition regime can be stretched."

Make no mistake, the Justice Dep playing hardball. Nigel Potter, the 59-y old former chief executive of British g bling company Wembley PLC, found out the hard way when he flew to the in an attempt to clear his name on bril charges. He was soon convicted an now serving a three-year term in a Pe sylvania jail. Says his wife, Joanna: " only crime was being naive."

–With Eamon Javers in Washin

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Window Shopping At Saks

The numbers don't look so good, but potential buyers are still browsing

BY JUSTIN HIBBARD

IN CASE THERE WAS ANY DOUBT that private-equity firms are high on retailers, two deals in the past month served as reminders. On June 22 buyout shop NRDC Equity Partners announced plans to shell out $1.2 billion for Lord & Taylor, a unit of Federated Department Stores Inc. Eight days later, Bain Capital and the Blackstone Group said they would pay $6.2 billion for Michaels Stores Inc., a 30% premium over the crafts retailer's market value.

The deals heaped coals onto a question that has been burning for more than a year: What about that most iconic of retailers, Saks Inc.?

Since early 2005 the Birmingham (Ala.) company has been rumored to be in play. Trade publication *Women's Wear Daily* reported in May that private-equity firm Tri-Artisan Capital Partners and real estate mogul Vornado Realty Trust are making a run at the retailer. (Vornado declined to comment; Tri-Artisan did not return phone calls seeking comment.) At an investor conference on June 14, Blake W. Nordstrom, president of Nordstrom Inc., said he was "kicking the tires" on a deal. Bankers are fueling the speculation. "I don't see a place in the public markets for another single department-store brand," says Peter J. Solomon, chairman at boutique investment bank Peter J. Solomon Co. Adds Robert Baker, principal at NRDC: "Saks is a very interesting situation. There are a lot of opportunities in the brand, the real estate, and to improve sales."

But the more time passes, the more uncertainty hangs over Saks. It has been six months since former Chairman R. Brad Martin relinquished the CEO title to Stephen I. Sadove, then vice-chairman and chief operating officer, after the company disclosed that it would restate six years of financial results because of improper charges to suppliers.

If Saks's problems were easily fixed, a buyer would have already stepped in. The company has underperformed rivals for five years running. Sales are down 3.6% at a compounded annual rate; operating income, down 13.7%; and cash from operations, down 11.9%. Sure, that's partly because the company has sold divisions recently, but it's also because Saks has bungled basic functions such as inventory control. Management, which declined to comment for this story, has said it's fixing the problem. But inventory is hardly the only concern. Net income margin in the most recent quarter was just 1.5%, well below the industry average of 4.1%.

UNLOADING TIME

SAKS TELLS SHAREHOLDERS it's too early to judge how Sadove's turnaround is coming along. But the process really began almost two years ago under former CEO Martin. The onetime Tennessee state legislator bought mid-market department-store chain Proffitt's Inc. in the mid-1980s and expanded it through an acquisition spree in the '90s, culminating in the $3 billion purchase of luxury retailer Saks Holdings in 1998. But synergies between the two never materialized, and the company began jettisoning properties last July, selling Proffitt's and McRae's to Charlotte (N.C.) chain Belk Inc. for $622 million and, in May, Northern Department Store Group to Bon-Ton Stores Inc. in York, Pa., for $1.1 billion.

There's still more unloading to be done. Saks's other mid-market chain, Parisian, went on the block in January. Once management finds a buyer, it can focus on Saks Fifth Avenue Enterprises, the last remaining business. This fall, the division will bring back a private line aimed at its core 35- to 55-year-old customers in a bid to juice sales.

Meantime, shareholders cling to positive news. Since Sadove took over, Saks has reported results only for the quarter ended Apr. 29. Comparable-store sales fell 2.2% at SFAE, which generates 65% of total revenue. But in May comps rose 0.8%. That was enough progress to fan hopes that a knight in shining armor would swoop in and buy Saks—but not enough to make it happen.

PRICED TO MOVE

Data: Bloomberg Financial Markets

Serving Two (Station) Masters

More spending may assuage Burlington Northern's customers, but not Wall Street

BY CHRISTOPHER PALMERI

THESE ARE BOOM TIMES for railroads, and it's perhaps most pronounced at Burlington Northern Santa Fe Corp. The nation's second-largest railway, based in Fort Worth, smartly targeted the fast-growing business of shipping international cargo containers by rail. At the same time, demand for traditional cargo such as coal, chemicals, and agriculture has surged.

Burlington Northern has enjoyed nearly unmitigated pricing power, using fuel surcharges to pass on rising energy costs and raising rates substantially on top of that. It competes with trucking, but that method costs at least 15% more, and some goods simply can't be shipped that way. Since 2001, the company's profits have doubled, to $1.5 billion, on $13 billion in revenue, helping land it the No. 12 spot on the BusinessWeek 50 list of top corporate performers. With a full head of steam, Burlington Northern Chief Executive Officer Matthew K. Rose is focusing on massive infrastructure upgrades—capital spending is expected to rise 15% this year, to $2.5 billion. For his customers, more capacity can't come soon enough. But investors, wary of a cyclical downturn, have already begun to punish the stock.

Customers are getting tired of swallowing Burlington Northern's price increases, especially as demand causes service to slip. Left with little choice in how to ship their goods, however, they've been at the railroad's mercy. At the Laramie River Station, a coal-fired power plant in Wheatland, Wyo., Burlington Northern trains are running an average of 10 hours behind, says station spokesm Floyd Robb, while the station's shippi costs are double 2001 levels. The frustr tion is so intense that several shipp groups are pressing Congress to rein railroads' pricing power.

Rose thinks that more investment w help quell his critics. "You'll see the no go away," he says. In fact, some of Ros bets have already paid off. A logistics ce ter in Joliet, Ill., housed in a former Arr munitions plant, was built in 2002 speed delivery of shipments flowi through nearby Chicago. Wal-Ma Stores Inc. just opened a 3 millio square-foot distribution center on si Originally planned to move 1,000 car containers a day between trains a trucks, it'll be up to 2,700 next year.

Burlington Northern also outflanked val Union Pacific Corp. by laying doul track on most of the 2,200-mile Chicag Los Angeles route, so that trains wo have to wait on a sidetrack for those co ing the other way. That shaves a day off t typical five-day journey in each directi

The Best Performers

"They've really made a big pu to reach out to importers," sa Wayne Thompson, director global logistics at Madis (Wis.)-based Pacific Cycle I which imports Schwinn bicyc from China. Burlington Nor ern now gets more than a th of its business from container traffic, just 19% for Union Pacific.

HIGH "VELOCITY"

AS THE PEAK summer shipping seas draws near, Rose is also pushing workers, launching a productivity dr that he has dubbed "velocity." Burli ton Northern now ties 30% of emplo bonuses to improvements in the numb of railcars shipped per mile. In Los A geles, terminal superintendent Charle Potempa used to send trains out Memphis with 180 cars, figuring th could pick up a few more along the w Now he'll hold the train until he c come up with a full load of 250 cars full load can then run nonstop to its d tination, saving time.

But analysts have taken a dim view the spending. Burlington Northern sha rose 250% in five years, but have slid 1 in the past three months. If the econo turns down, railroads will suffer—a that investment will have been wast Donald Broughton, a transportation a lyst at A.G. Edwards Inc., told his client sell train stocks earlier this year. He sa "If they were behaving like rational du olists, they wouldn't invest a dime."

FAST TRACK
Profits have doubled

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Your Attention Please

As the mass market fragments, the Web opens up ways to put it together again

BY HEATHER GREEN AND ROBERT D. HOF

IF YOU WANT TO KNOW WHY MEDIA and advertising executives look so grim these days, spend a few nanoseconds with Adrianna Montague-Gray. That's all the time she's got. The 28-year-old public relations manager at a New York nonprofit group hasn't bought a daily newspaper in four years and rarely watches television. Instead, she flits like a hummingbird from one new Internet medium to the next—scanning Web log posts at Bloglines, tuning into her own customized online radio at Pandora.com, sharing articles with friends on Yahoo's Web bookmarking service del.icio.us, downloading podcasts from National Public Radio. Says Montague-Gray: "I like being able to read or watch what I want, when I want."

It's not just that media is splintering, as it has been for decades. The difference now is that the Internet is thrusting that trend into overdrive. With every quick click, millions of people like Montague-Gray are slicing and dicing media into ever-tinier little bits, just the nuggets they want and nothing more. And by the millions, they're reassembling them into personalized digital channels of their own choosing—all too often, minus the advertisements that sustain nearly all media today. The result: a serious case of attention deficit for every business that depends on traditional mass media to reach customers.

It's an affliction plaguing everyone

from master marketers such as Coca-Cola and Ford to ad agencies to newspaper chains, TV and radio networks, even Internet powerhouses like Yahoo and Microsoft's MSN. They're all scrambling to answer the central conundrum of their existence: How do you reach folks who don't sit still long enough to see or hear ads—and who use their iPods and TiVos to vaporize them instantly?

Truth be told, too many marketers and media outlets have no clue. But there's a glimmer of hope emerging for these embattled industries. Because even as the Montague-Grays of the world are disassembling media in the Digital Age, they're also reconstructing it. In these millions of networks-of-one lies a surprising opportunity: the chance to engage the masses one by one instead of hoping some ad punches through the flatlined brains of couch potatoes.

String together enough of these micromarkets of customers, the thinking goes, and you will get something that adds up to a new kind of a mass market. After all, the same Net that lets people decide what to watch or read also helps media and marketers to target them with unprecedented accuracy and efficiency. By their very online actions—links on their blogs, the digital breadcrumbs left by their Web browsing, the reviews they post on Amazon.com Inc., the video clips they share on MySpace—these new minimedia moguls essentially reveal exactly what they want to watch or read or buy.

Netizens are minimedia moguls. They want what they want, and they want it now

"INSTANT OF TRUTH"

BUT WHAT MATTERS is not how many eyeballs you pull into a Web page. More than ever, the key is what they're doing there. Hours spent building a MySpace page may end up having no economic value; a split-second click to a mortgage ad is something for which a lender may pay $50. So in the new world of micromarkets and accompanying micromedia, simply getting people's attention isn't enough, says Don Tapscott, co-author of the upcoming book *Wikinomics*, about the

RYAN HESHKA

sweeping impact of mass collaboration on business. Instead, he says, the key is catching that attention at the "instant of truth"—when people are ready to buy—and providing just the right information they need to make a decision.

A few leaders are finally doing just that. At Nike Inc., marketers are moving beyond ads to engage online communities of fanatic customers whose word-of-mouth strengthens the brand. A 21st century ad agency, Efficient Frontier, is showing how math and technology can target specific groups of shoppers, so that they're more likely to pay attention to the ads. And perhaps most surprising of all, the British Broadcasting Corp. is handing its programming over to viewers for them to remix and reformulate, engaging their attention at a much deeper level.

Nike has set up a Web site where soccer fans can network

Here's a look at how each of these three companies—an innovative consumer products marketer, a newfangled advertising middleman, and a traditional media outlet—is shining a light on how to navigate this strange new digital landscape.

Nike It's Not a Shoe, It's a Community

FEW COMPANIES DEFINE 20TH century marketing better than Nike. The athletic shoemaker's famous swoosh emblem and a string of ad campaigns, starting with its iconic "Just Do It" series, set the gold standard for getting a clear message to a mass audience. But when Nike crafted its World Cup strategy, it decided to try something new: online communities. The centerpiece is Joga.com, a social networking site for soccer fans it quietly launched in February with Google. Members in 140 countries can blog, create fan communities around their favorite teams or players, such as Brazilian superstar Ronaldinho, organize pickup games, download videos, and rant against the encroaching commercialism of the game. And though the program was launched during the World Cup, it continues beyond the tournament.

It's a huge U-turn for the mighty marketer—and a recognition that it needs to get consumers' attention in entirely new ways beyond blasting top-down mass messages. Nike was forced to be innovative after rival Adidas Group got a World Cup exclusive deal to broadcast ads in t U.S. But by monitoring conversations social networking sites and blogs, wh people already are shaping Nike's bra the sneaker giant knew this was an portunity to try something different. S Trevor Edwards, Nike's vice-president global brand management: "Gone are days of the one big ad, the one big sh and the hope that when we put it all gether it makes a big impact."

JOGA BONITO

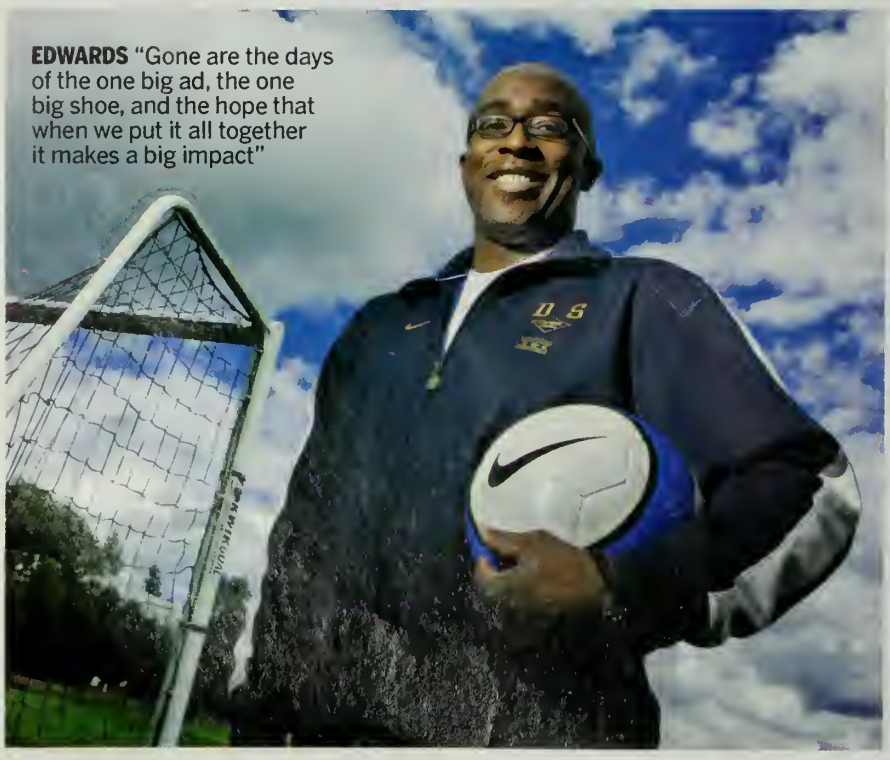
THE JOGA.COM SOCIAL networking s one of the biggest by a large consun company, is just one piece of a $100 n lion multilayered campaign known Joga Bonito (Portuguese for "play beau ful"). Last fall, Nike started feeding vi clips that spotlight Nike-sponsored soc players onto popular video sharing si including YouTube and Google. It crea JogaTV, a virtual soccer TV station, wh it releases a new video clip every few d and fans can upload their own clips.

Is it working? Nike officials say t reached their World Cup goal of sign up 1 million members by mid-July, w the tournament ended. "By enrolling c sumers in shaping the marketing, Nik figuring out what kind of microcont audiences want and nurturing dee bonds of loyalty and advocacy," says F Blackshaw, chief marketing officer Nielsen BuzzMetrics, which tracks onl conversations for companies.

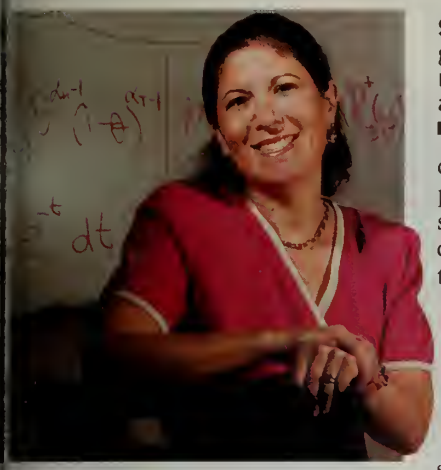
Yet like a lot of companies trying build online communities, Nike doe know if this will filter down to the bott line. The company says sales of its soc gear are booming but admits it's too e to credit that directly to its commu bear hug. What's more, this kind of m keting can be tricky. One of Nike's top s cer videos, for instance, shows Ronalc ho slipping on a pair of new white N soccer cleats and booting a soccer ball f times off the goal crossbar—the equi lent of a baseball hitting off the left f foul pole into foul territory. It has b viewed by 7.5 million people, makin one of the most popular clips online, also the most controversial because it digitally altered. Nike executives, v won't say whether they did the editing, clearly amused by the controversy. But flap could hurt its credibility.

Still, Nike considers the results pror ing. Says CEO Mark G. Parker: "A str relationship is created when some joins a Nike community or invites N into their community." Which is the p of brand marketing, isn't it?

–By Stanley Holmes in Sea



EDWARDS "Gone are the days of the one big ad, the one big shoe, and the hope that when we put it all together it makes a big impact"



SIMINOFF The Net gives advertisers more visibility and control

Efficient Frontier Hacking Madison Avenue

THEY MAY NOT LOOK SO SEXY, those four-line ads on the right side of the page when you do a Google search. But Rob Wood loves them. After all, they let ood—director of marketing and merandising at building-materials wholeer Build Direct Technologies—and ner advertisers create their own minirkets defined by the words searchers e in. But until last summer, Wood was ending several hours a day tracking d changing bids on 1,500 terms on ogle and Yahoo! "It was very time-conming," he says.

ORDS FOR SALE

ITER EFFICIENT FRONTIER INC. This w Age advertising agency operates just e Madison Avenue shops, in a sense. one side, it has ad clients, folks like od. On the other, it has access to a rtfolio of ad space—in s case, the Web search enes. It matches the two. t that's where the similares end.

The 70-person Mountain ew (Calif.) startup is the gest buyer of keywords on ogle, some 15 million a y. Borrowing mathemati formulas developed for all Street portfolio maners, Efficient Frontier's mputers sort through upard of 10 billion variables, such as the number of people who search using particular words and changes in what companies bid for their ads to appear on pages with those keywords. Then they spit out the optimal mix of keyword purchases and suggest adjustments throughout the day. Efficient Frontier claims that, on average, its method improves measures such as the rate at which people click on ads by 30%.

Wood, whose company operates over the Web, can buy 10,000 keywords on Google and 6,000 on Yahoo. Since he started using Efficient Frontier, he's seeing people on average click on twice as many of his ads. Wood's sales are up 35%, even though his marketing budget is flat. "The reason people spend on Google and Yahoo is not that it's sexy but because it gets results," says Ellen Siminoff, CEO of Efficient Frontier and a former Yahoo executive. "It's about visibility and control—and they can get that on the Internet."

Even search ads may not be the endgame. John Hagel, a consultant and author of several books on the Net and business, notes that the problem with advertising of any kind is that it essentially aims to hijack people's attention. "You have to move from an intercept model to an attraction model," says Hagel.

Still, few expect search marketing to slow anytime soon. Siminoff believes that ultimately any kind of digital media, even TV, can be optimized the same way. Suddenly, ad agencies, which depend in part on the difficulty of marketers and publishers to measure results, are facing an onslaught of highly analytical competitors. They could be staring at the companies that will replace them as media goes digital. ■

–By Robert D. Hof in Mountain View, Calif.

BBC Step Right into The Telly

UNDER THE TENT, THEY danced, waving fluorescent glow-sticks to the beat of bands Franz Ferdinand, Snow Patrol, and Pink. The British Broadcasting Corp. pulled out all the stops for its free One Big Weekend concert on May 12 and 13, renting an island, complete with tents and a huge stage. There was just one twist: It was all virtual, existing in the online game Second Life. The event mirrored the BBC's real world concert, held simultaneously in Dundee, Scotland. Some 30,000 people made it to Dundee, but 6,000 others attended while sitting at their PCs.

Not just any 6,000 people, mind you. A very committed—some might say, fanatic—group that spends hours constructing the Internet role-playing game. Just the kind of young, tech-savvy participants that the BBC, the archetype of old media, needs to engage.

The Second Life concert is just one part of a digital mission the Beeb, as it's known, is undertaking to revamp itself radically. It's driven by the conviction that technology is turning plain old-fashioned content into a commodity, one that's losing the attention of viewers and listeners.

As a publicly funded broadcaster—each TV-owning household in Britain pays an annual license fee, raising $5.5 billion in funding—the BBC must justify its value amid constant debate about the payments. With control shifting from the media to the

The BBC thought that its content was losing viewers' attention

HIGHFIELD Allowing the viewers to create a Beeb of their own

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lience, the BBC wants to turn its audi-
es into participants. "The second
e of digital will be far more disruptive
n the first, taking us beyond broad-
ting," says Mark Thompson, director
ieral of the BBC, the fourth-largest
bal digital news brand.
This ambitious new strategy puts the
C leaps ahead of commercial rivals.
t only is it making radio and TV shows
ilable on demand, it's surrounding
t content with more personalization,
ial networks, and public ratings, shar-
, and reporting.
n part, the BBC can experiment be-
se it's unfettered by advertisers or
reholders. These moves, announced in
il, immediately had commercial
adcasters up in arms. Even Rupert
rdoch's News Corp., with $1.2 billion
ested and growing in the new digital
ne, is starting to worry because of the
eat the BBC represents to News Corp.'s
Space social network. Rivals complain
t the strategy will crush competition
l have called for a government review.
ners reckon it will have the opposite ef-
t. "The BBC is a model for media com-
nies," says Tim O'Reilly, CEO of O'Reil-
Media Inc., which popularized the term
b 2.0 for new services. "They are push-
the envelope to gauge how they en-
ge their audience in new ways."

ICE 'N' DICE

E REVAMP centers around three con-
pts: find, play, and share. Find is about
king the BBC's content easier to navi-
e through improved search, links to
b content, and lists of popular content.
y revolves around the MyBBCplayer,
w in trials, which lets British users
wnload current radio and TV programs
ytime up to seven days after broadcast.
Share is where things really get inter-
ing. Along with plans to let the public
ate blogs, link to content on and off its site, and upload videos, the BBC is developing tools that allow individuals to download its content and build on it. One project lets Britons download footage from BBC news and science shows, remix them, and eventually share them online. More radical is backstage.bbc.co.uk. The BBC is opening up its data in formats that users can remix to yield new ideas for the BBC site. So far, users have combined BBC data on sports, traffic, and weather with Google maps. A prototype called Sport Map allows people to find the nearest soccer team on the map and get its latest news. "One of the big pushes of Web 2.0 is to ramp up our knowledge of our audience," says Ashley Highfield, the BBC's director of new media and technology.

While other media giants fear or even fight technology, the BBC is embracing it, challenging conventional wisdom in the process. "They're teaching the broadcasting industry that it's not about owning more content," says Jeff Jarvis, a media consultant. "It's about opening it up."

–By Kerry Capell in London

BusinessWeek online To read how ABC used podcasting, blogs, and fake sites for buzz, go to businessweek.com/extras

PLAYBOOK: BEST-PRACTICE IDEAS

Fighting Attention Deficit

New strategies for engaging customers on the Net:

RALLY COMMUNITIES TO BUILD YOUR BRAND

Customers can be your best evangelists, so don't limit yourself to broadcasting marketing messages from the media housetops. Jones Soda, for instance, engages customers through music- and photo-sharing sites, building loyal and vocal communities. With no traditional advertising, Jones has grown from a Seattle fave to a $33 million national beverage business.

TAP THE WISDOM OF CROWDS

Why do all the work yourself? Viewers, listeners, and readers are smart—often smarter than your own employees—so let them improve your products and services. *The New York Times* is redesigning its site to harness readers' searches, blog posts, and movie ratings to rate and filter the vast Web wasteland. Even its initial efforts helped traffic jump 12%.

HIRE THE AD GEEKS

Don't try to guess which search words will bring in the most buyers. Instead, bring in the experts: search-engine optimization firms. One outfit, Efficient Frontier, uses Wall Street portfolio management techniques to help Lending Tree, Build Direct Technologies, and others improve click-through rates on search ads by an average of 30%.

EXPLODE YOUR BRAND

Forget about trying to create loyalty to a network. Viewers, readers, and customers today care only about a particular show—but then they want to immerse themselves in it. The SciFi cable channel offers podcasts, behind-the-scenes video blogs, and remixable video downloads tied to *Battlestar Galactica*. The show's audio podcast alone has been downloaded 4 million times.

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The best way for this world leader in delivery services to move more packages is to move more information. CA software solutions enabled DHL to unify and simplify its global package tracking system. The increased efficiency gives DHL the ability to handle more packages more accurately. With CA's help, DHL put the customer service back in shipping as it delivers on over one billion promises each year.

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From Yawn To *Yipes!*

The new XPS line is sleek, sexy eye candy. So is Dell getting cool?

BY LOUISE LEE

DELL INC., KING OF THE bland box, has suddenly discovered design. Check out its new XPS M2010, a cross between a desktop and laptop targeted to entertainment enthusiasts. The $3,500 machine, which features a detachable wireless keyboard and monitor with adjustable height, has a matte-black leather-like exterior, making it resemble a luxury briefcase when closed. Meanwhile, Dell's new $1,990 XPS 700 desktop, aimed at hard-core video gamers, has side lights meant to add flash and grilles resembling those of a fancy sports car.

The Round Rock (Tex.) PC maker hopes a few of these design flourishes can help pull it out of a low-margin hole. Long the most efficient PC maker, Dell has suffered lately as rivals such as Hewlett-Packard Co. match or even undercut its prices. Now Dell is trying to turn a few heads and sell some higher-priced machines by experimenting in the opposite direction.

The company has beefed up its internal team of industrial designers, recruiting from auto makers, consumer products marketers—even a German watchmaker. It has expanded links to outside design firms. And two months ago Dell bought Alienware Corp., whose sleek machines, modeled after the beast from the movie *Alien*, are legendary among gamers.

Just don't expect to see many signs of this design renaissance on your workaday desktop any time soon. Most of the attention so far is focused on the newest XPS PCs, which are aimed at ultra-narrow audiences. The entire line represents only about 1% of Dell's total 2005 sales of $55.9 billion, estimates Majestic Research Corp. Focusing on those machines makes sense, given the coolness imperative of the gamer community and its willingness to pay more for hot-rod PCs. "If you want to go into the gaming space, you can't take a standard rectilinear, bland-colored box," says Dell Senior Vice-President John K. Medica, who oversees the design efforts.

Most outsiders are skeptical, moreover, that Dell will pay more to jazz up its mass-market machines. Dell's whole business model is based on squeezi every nickel of cost, and it already plans spend a hefty $100 million this year improve customer service. "Whether D can improve its overall designs depe on how radically it can adjust its cultu says Bob Djurdjevic, president of t consultancy Annex Research Inc.

Dell acknowledges that it is not ov hauling the looks of its mainstream P Insiders say that while the aim is to m the XPS line seem "sophisticated" a "unexpected," Dell's other machi should be "approachable," "innovativ and "fresh." Thus, familiar lines like Dimension desktops are destined to main looking relatively ho-hum, alt with some changes such as alt ing the finish to make th look sleeker.

THE XPS "If you want to go into the gaming space, you can't take a... rectilinear, bland-colored box," says design czar Medica

SPILLOVER

MEDICA HOPES the gar PCs will generate good f ings that spill over to De other lines. That clearly wo for some consumer go makers, as seen with Daim Chrysler's expressive 3 sedan and Target Cor "cheap chic" housewares.

Yet, does the average user ally care about cool looks? H have tried to find out. In 20 boutique brand Acer Inc. in duced its "Ferrari" lapt bright red machines sport the race car line's prancing-ho emblem. They have a limited au ence, but do produce chatter aro the Acer name, analysts say.

In fact, most of Dell's effort on mass-market PCs is to make them ea and more comfortable to use. No de has been spared. Starting in late 20 Dell set out to revamp the controls laptop touchpads. "The buttons w noisy and didn't feel nice," says Dell s ior manager Keith Kozak, who overs the project. Scores of customers were cruited, at $75 each per session, to de how much noise was tolerable and w buttons were most comfortable.

Within months, Dell produced a k board with new touchpad buttons. I proclaims them a success: The butt now produce 41 decibels, vs. about 51 fore. And they drop 1.3 to 1.6 millime before bouncing back, vs. 0.5 previou Take that, HP. ■

BusinessWeek online For a slide show of Dell's designs and a Q&A with Alienware's CEO, go to www.businessweek.com/extras

Woo-hoo²

"Vonage's call quality, customer support and features make it our top pick for Internet phone service." – *CNET*

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Vonage
July 2006

Two great reasons to switch to Vonage. Want more? Go to www.vonage.com

Vonage

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Retirement Guide

After charging through a high-powered career, with endless meetings, phone calls, and e-mails, you'd think you'd be ready to slow down and kick back. Nothing to do? Of course. Isn't that the point of retirement?

Only after the action stops do many retirees realize they need to replace the stimulation, the social network, and the psychic rewards that come from work. Retirement planning is not just about how much money you need but also about how to fill your time with worthwhile pursuits.

In our Annual Retirement Guide, we'll help you get your head ready for the next phase of your life. You can do this online or with coaches, or even by going to retirement school. Take your spouse, too, since retirement changes a relationship as much as getting married or having children does.

Our guide doesn't ignore the finances. Some mutual funds that are run specifically for retirement savings are changing how they invest. And there are some new twists in annuities, investments that guarantee income for the rest of your life.

And when you have all these things worked out, you can settle back in a comfortable lakefront cabin or a mansion by the sea. That's something to dream about.

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Stay Happy, Together 67
Age-Targeted Funds 68
Tips on Inflation Protection 70
New Wrinkles for Annuities 72
Three Great Places to Retire 74

On the Air and on the Web

BusinessWeek Weekend

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- One reviewer's experience with retirement testing and counseling
- Download retirement planning worksheets
- Plus a podcast hosted by Executive Editor John A. Byrne

Go to www.businessweek.com/extras

First house: age 23. First child: age 28. First e-mail: age 95. Helen Burcham Green, age 104, has always embraced change. In 1919, after her father passed away, she packed up her things and headed all alone to a new life in San Francisco. Her ability to adapt has served her well, not just 87 years ago, but also today. In addition to welcoming innovations like the radio, the telephone, and television in her lifetime, she has

104

recently mastered the Internet. Of course, Helen's not alone in her desire to change with the times. That's why Genworth Financial created Total Living Coverage.[SM] It's life insurance that, if you need it, can also provide long term care insurance protection. Most importantly, as your needs change, it offers you the flexibility you not only want but deserve. So you'll be ready, no matter what the future may hold.

To find out more about all Helen has seen, visit genworth.com/100

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line program called My Next Phase this spring, she learned her job is her main creative outlet. Since she plays the guitar and sings, she intends to make music a priority in retirement. But Van Deren's main takeaway was a realization that rather than retire in five years, she'd prefer to stick around for 10. "I discovered that I can't easily replace the things I get from work," says Van Deren, who points to the rewards of collaboration with and recognition from colleagues. Van Deren was one of 10 employees to try My Next Phase for Methodist, which plans to offer it as an employee benefit next fall.

To find out how useful such planning tools are, *BusinessWeek* tried out three of the more in-depth online services. My Next Phase costs $39.95, $109, or $395, depending on whether you go it alone, register for five phone-in classes, or hire a coach for five sessions. Two others, Turning Points Navigator and Retirement Success Profile, require you to work with coaches, in person or on the phone, who typically charge $75 to $150 an hour. With each, the number of sessions you do will depend on your needs and your coach's approach.

Bottom line on these programs: "I got to know myself a little better," said one reviewer

High Marks

OUR THREE TESTERS, all full-time journalists in their 50s, spent as much as 12 hours taking diagnostic tests, writing answers to probing questions, and discussing the results with coaches.

Going into the programs, some were skeptical: "I'm pretty much a do-it-yourself guy who won't even go to an outsider to do tax returns," said one. "I'm not keen on the idea of spending a lot of time analyzing myself and discovering problems I wouldn't ever have known I had." Along the way they encountered a few computer glitches and at times got some puzzling feedback.

But even the skeptics were won over to the idea of this kind of planning. Our reviewers liked that all three sites encouraged them to explore not only leisure, intellectual, and spiritual pursuits but work-related ones, too.

While they drew insights from the exercises they did on their own, all saw the value of working with a coach. "Having a coach provided some discipline that I probably wouldn't have mustered on my own," said one reviewer.

Before taking on more extensive programs, try the free Retirement Strengths Worksheet at retirementwellbeing.com and businessweek.com/extras. It captures key elements of the retirement planning process in one exercise that combines an online test of personal strengths with a worksheet that asks you to think about how you use these in your job and how you might use them in retirement (table).

Not surprisingly, we discovered that the more you put into these programs, the more you get out of them: "Bottom line: I got to know myself a little better," said one reviewer.

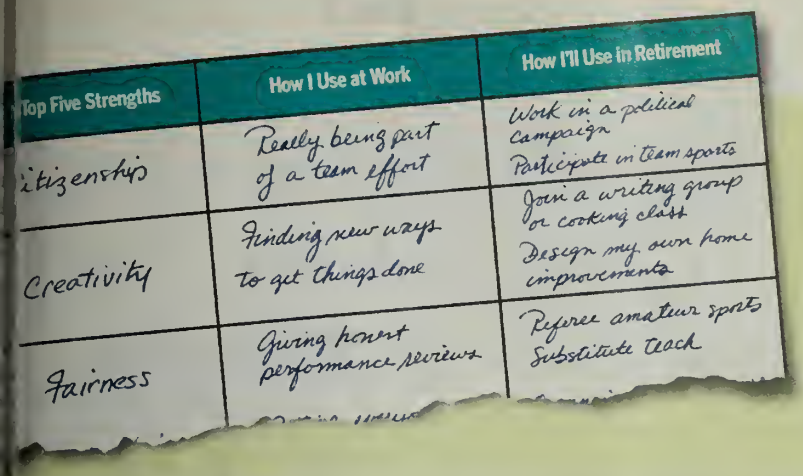
Our reviewer gave high marks to **My Next Phase,** which has been on the market for a year. Developed by a clinical psychologist, a psychology professor, and an entrepreneur, the program is a well-organiz four-step process.

The first part is devoted to introsp tion. Our tester had fun answering qu tionnaires that analyzed his personal and asked about what things fulfill hi from "independent accomplishment" "social connection." He was told t work is his main source of "recognitio "creative expression," and "purpose."

How did the program figure this o Co-founder Eric Sundstrom says the s ware relies on psychological research t indicates certain things come more ea to some personalities than to others. example, because a "visionary" thinke likely to have less trouble finding new c ative outlets than a "practical" think the program figures that practical ty depend more on work for creative ful ment. By and large, our reviewer felt findings were on target.

Next, our reviewer did exercises to h him zero in on satisfying substitutes work. He made lists of past hobbies, h py memories, and classes he liked. winnowed it to four pursuits that bala

VAN DEREN found that "I can't easily replace the things I get from work"



Top Five Strengths	How I Use at Work	How I'll Use in Retirement
Citizenship	Really being part of a team effort	Work in a political campaign Participate in team sports
Creativity	Finding new ways to get things done	Join a writing group or cooking class Design my own home improvements
Fairness	Giving honest performance reviews	Referee amateur sports Substitute teach

Prepping for Retirement

Just how will you spend your time during retirement? To help organize your thinking, try this mind-bending exercise. It helps you identify your strengths and figure out how to use them in your golden years. We've provided an example, but you can go to retirementwellbeing.com or businessweek.com/extras to get a copy of a blank, along with more detailed instructions, and try it yourself.

Data: John Nelson, Christopher Peterson, and Martin Seligman

rk and leisure: piano lessons, travel, rting a publishing venture, and devel- ng content for a TV show. Although software had glitches—our reviewer one essay twice before he finally saved he gave the service an A. "I knew my was a huge source of fulfillment, but s course drilled it into my head how portant it is to replace that."

Launched in January, **Turning Points vigator** is based on workshops that a mer human resources executive at what was Mobil Corp. developed in the 1980s. It got a mixed review.

As with My Next Phase, Turning Points Navigator prompts you to do some reflecting before designing a game plan. The program requires you to engage one of the five coaches it has ties to and gives you a two-year subscription, which is helpful because the material can be overwhelming. The first of eight sections alone, titled "Who Am I?," consists of over a dozen exercises that prod you to take an inventory of your strengths, weaknesses, and values. While it provides a personality test and some checklists, most of the exercises require you to write out answers long form. Our reviewer cautions that "the person who goes through this program must be willing to devote a fair number of hours."

You also have to be committed to a more complete self-examination than is the case with the other programs. Our reviewer sometimes felt as if she had landed on a psychiatrist's couch. Still, she gained insights that will be useful in retirement planning. For example, while analyzing her accomplishments, our reviewer, who thinks of herself as a cautious type, discovered that each had required her to take a big risk, such as moving abroad to pursue a career change. It forces you to "dig deep into yourself and makes you think," says Katy Eymann, whose nonprofit Life by Design Northwest develops retirement workshops that companies can offer employees. It plans to make Turning Points Navigator part of a retirement program it hopes to launch to the public. "We believe questions such as how to make a difference or find fulfillment warrant taking time to think about," says Turning Points CEO Mike Ballard.

In **Retirement Success Profile**, our reviewer thought some of his results were off-base but gave this program, created 15 years ago, solid marks for identifying areas he needs to work on. St. Louis counselor Richard Johnson created this program as a three-step process.

At the program's core are 120 questions designed to measure how ready you are to retire. You indicate how strongly you agree or disagree with various statements on a scale of 1 to 10. Then the software compares your responses with those of the 30,000 others who have taken the exam and scores you in 15 areas, such as your attitude toward retirement, the extent to which you have leisure interests, and the degree to which your identity is tied up in your job.

The report won't do you much good without talking it through with one of the more than 500 coaches in the service's network. Some will take you through the process, including various exercises, in just one session, while others require you to sign up for as many as eight. Johnson, who coached our tester, provided insight into the results and pointed out areas that merit exploration, such as figuring out ways he can define himself beyond work.

The final step is to develop an action plan. Johnson recently introduced a shorter tool, called LifeOptions, which measures retirement readiness in six categories, including finances, health, and relationships and must be done with a coach, as well. We recommend sticking with the longer program. For our tester, the analysis made more sense and was more thought-provoking.

Sure, these programs require a big commitment of time and money. Then again, so do 25 years of retirement. ■

–With Mark Morrison

Focusing Your Mind On the Future

AM/URL	COST
r Your Drivers **ll.ml.com/html/mlrr_explore_drivers** n the book *Don't Retire, Rewire!*, this exercise forces you on what really motivates and fulfills you.	Free
t Phase **hase.com** wer gave this service an A. It takes time but yields results.	$39.95-$395*
ent Success Profile **ntoptions.com** s your readiness to retire and helps you get better prepared.	Approx. $75-$150/hour**
ent Well-Being **ntwellbeing.com** the basics of planning in one succinct exercise.	Free
Points Navigator **tor.com** ted to someone willing to spend a lot of time thorough self-examination.	Approx. $100/hour**
cond Life **ndlife.org** is personality test is fun, it's hard to take y the list of suggested activities.	Free

se costs $39.95, $109, or $395, depending on whether you go it alone, register for five es, or hire a coach for five sessions.

set their individual prices.

Chris Johnson, Founder & CEO, Priasoft

Chris could always see beyond the garage where he started his software company. American Express could see beyond it, too. They gave him the financing and payment flexibility he needed before anyone else would. How long did it take his bank to realize he had a good idea? "Two years and two weeks too long," says Chris.

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For Small-Biz Owners, It's Tough to Let Go

Small-business owners, many of whom started their companies and nursed them for decades, often have a hard time living the life of a retiree. ational Correspondent Mark Morrison oke with Eric Sundstrom, co-founder of irement-planning service My Next ase and professor of psychology at e University of Tennessee, about e special challenges entrepreneurs nfront as they near retirement age.

SUNDSTROM Best-case scenario for entrepreneurs: Find a commitment as engaging as work was

ow is an entrepreneur different from corporate employee in planning for tirement?
e main difference is in ego investment—ychological involvement in the business. mall-business owners and entrepreneurs e involved and invested and personally entified with their businesses in ways at employees in large companies st aren't.

hen should they start thinking about tirement?
's hard to say when, because they don't el the same pressure as an employee to retire by a certain age. They make the rules, and they don't have to retire if they don't want to. It's rare for a person to walk away from the business unless they want a child to take over.

Otherwise, if they show up on our doorstep for retirement counseling, they are usually being forced to slow down by some kind of physical infirmity or other factor that makes it impossible to keep on doing what they've been doing.

When is the best time to plan an exit strategy?
I don't think you can start too soon. You need to look far forward: "When will I likely not be able to do everything I'm doing now, and who will take my place?"

Can you give us an example of a small-business person who made a successful transition to retirement?
A marketing executive, a member of a retailing family, decided to do a family genealogy. She went about it much the same way as she did her marketing job and replaced her career with a new pursuit that would take a lot of commitment and social engagement. The focus of this work was to satisfy the family's interest in its roots instead of the old focus on satisfying the customer.

And the opposite—a plan that fails?
In one small food-processing company, the head of sales has envisioned sitting by the lake in a cabin he has built. He's about to flunk retirement because he's leaving a job in which he has contact with people 10 hours a day.

I've tried to dissuade him, but this is his dream, and he thinks this is what retirement is.

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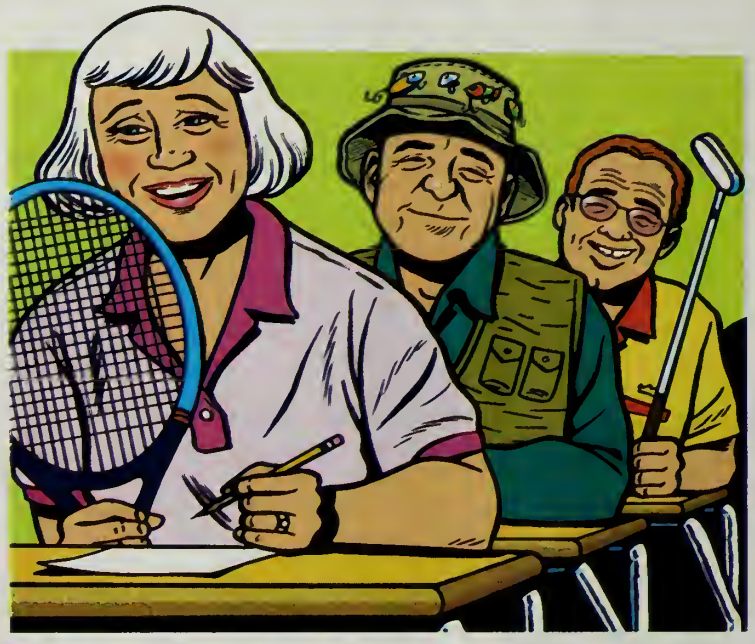
A Course in What Next?

» Seminars and workshops can help clarify what you want. BY ELLEN HOFFM



IN THE COURSE of a lifetime, people pick up the knowledge and skills to build careers and raise families. But not much of that prepares them for life in retirement. How do you manage your time? How do you keep your mind sharp? How do you adjust to all the spousal togetherness? They sound like seminar subjects—and they are.

Just as people take classes to prepare for other major life changes, whether it's job advancement or first-time parenthood, prospective retirees are studying for their next act. This type of planning goes beyond the workshops that employers and financial-services firms offer to teach you how not to go broke after you stop working. Courses such as a 2½-day workshop at the National Center for Creative Retirement at the University of North Carolina in Asheville (www.unca.edu/ncccr) focus on mindset and lifestyle, not 401(k)s and annuities.

"When people begin thinking about retirement, preferably 10 years before and no less than five, they need to plan in detail for what they're going to do with their time, how they'll replace the social relationships they had at work, and where they might want to relocate," says Betty Meredith, director for education and research at the International Foundation for Retirement Education in Lubbock, Tex., which trains retirement specialists. But William Arnone, practice leader for employee financial services at Ernst & Young in New York, estimates that just "5% or fewer" of the retirement programs offered to employees address nonfinancial issues.

Only about 5% of employer-sponsored programs address nonfinancial issues

One way to seek answers is to find a "life planning" adviser, whose goal is to integrate lifestyle decisions with financial planning. (Check the Kinder Institute for Life Planning, which trains practitioners, at kinderinstitute.com.) But many people prefer a group experience where they can interact with others like them. Take Jan Fulwiler, 54, a Madison (Wis.) psychologist who attended "Paths to Creative Retirement in Uncertain Times" at UNC-Asheville. She says she found it useful and fun to spend a weekend with others who are grappling with the same issues. The workshop confirmed her plan to gain professional credentials so she can offer retirement planning classes in her community.

The program ran Friday morning through Sunday lunch in a large, airy classroom. There were a dozen participants, mostly in their mid-50s, who paid $500 each for the course, with meals. The group included ex tives, a nurse, and a versity dean.

The tone set by th structors, NCCCR Dire Ronald Manheimer Assistant Director De Snodgrass, was frie and informal. But the dents took the prog seriously, working t way through lectures activities designed move them closer to sion of the retirement they want and the s they need to take to there. At the end, participant gave a minute presentation "first next steps" u digital photos, flowch posters, funny hats, and original poet

Charles Hughes, 67, an attorney in J son, Miss., said the seminar helped clear away the fog that had prevented from defining his future retirement. he plans to sell some acreage and incr his investment income. These steps says, will enable him to support a life that includes foxhunting and quail-sh ing in different seasons in various par the country.

Improv Exercise

PROGRAMS LIKE THE NCCCR's are starting to emerge around the cou Another is a four-day "Reinventing tirement" seminar held by Hudson I tute of Santa Barbara in California, w offers life and career planning ($1,99 an individual, $1,795 for an accomp ing spouse; hudsoninstitute.com.) other psychology-oriented retiren courses, the Institute uses a variet teaching techniques. One is improvisa exercises led by a professional actor. I tute CEO Pamela McLean says the e cises may be "anything from a clap movement to a sound you repeat sev

:s in unison," or creating a 10-
ute play by completing sentences
ted by fellow students. The purpose
) get participants to move outside
r usual way of thinking and be open
ew ideas, she says.
'you're looking for something local,
:k with adult education programs,
munity colleges, and financial advis-
n your area. Last spring, Diane An-
on, assistant director for careers and
loyment at Hudson Valley Commu-
College in Troy, N.Y., taught a class
ed "Finding Your Passion in Your
rement Years." It aimed to help the
articipants think about how to use
r interests and skills to make their
after work a positive experience.
eg Downey, a financial planner in
er Spring, Md., organized a 10-week
rse for Washington-area profes-
ıal women two years ago. She used a
nen's financial-planning book as a
, but she says about half the course
ısed on nonfinancial issues. Joanne
in, 57, a program manager at the
eral Aviation Administration, says
ıy of her friends were leaving the
shington area, and Downey's class
ed her realize that she should con-
r relocating, too. Planning to retire
about two years, she recently
cked out real estate in Austin and
ıston. She also signed up for a
nen's workshop in Texas because
vant to establish a social network be-
e moving, and this seems like a good
v to do that."
Even employers are moving beyond
ncial planning. Forest-products
ıpany Weyerhaeuser, based in Fed-
l Way, Wash., is considered a nation-
nodel. It offers a one-day multifac-
l retirement-planning program for
ployees under 50 as well as
ealthy-Wealthy-Wise," a 2½-day
ıinar for workers 50 or older and
ir spouses or partners. Benefits-edu-
ion manager Sally Hass says she an-
ınces the schedule a year in advance.
e classes, which accommodate about
00 people a year in various U.S. and
ıadian locations, fill up immediately.
ss says the goal is to help participants
ıre out how to use the "bonus years
ıave a meaningful life and not have
rets." One of her teaching techniques
uires participants to reflect on satis-
ıg past experiences and consider
v to replicate them in retirement.
Going to retirement school won't get
ı a degree to hang on the wall. But it
ıld set you on the path to a more ful-
ng life in your later years.

THE HEALDS Martha and John near their home in Delray Beach

Stay Happy, Together

» For retiring couples, lifestyle planning is as crucial as financial planning. BY ELLEN HOFFMAN

HE PREFERS MAINE. She favors Florida. He does some laundry. She still cooks most of the meals. As Martha and John Heald, married 38 years, settle into retirement, they're discovering the difficulties of making their separate lives mesh.

The push and pull is a common state for newly retired couples. "Retirement is as major a transition as getting married or becoming a parent," says Phyllis Moen, a University of Minnesota sociology professor who has studied how couples prepare for the sunset years. "Like becoming a parent, retiring transforms the marital relationship, puts it out of kilter for a while. You have to renegotiate."

One tricky decision is when to declare yourselves officially retired. Courtney Coile, an assistant professor of economics at Wellesley College in Wellesley, Mass., says for the current generation of retirees, "men have basically been at work since age 20, and their idea of their golden years includes spending some time with their wives." But in many cases, women have entered the labor force more recently, are thriving in their careers, and aren't ready to kick back.

To avoid conflict, such "out-of-synch" couples need to discuss their different timetables, and the one who quits working first should figure out a productive way to spend newfound time alone, says Nancy Schlossberg, a Sarasota (Fla.) psychologist who wrote *Retire Smart, Retire Happy: Finding Your True Path in Life.* How to fill the hours is also a question for couples who stop working at the same time.

The Healds have devoted as much time

to planning their retirement as anyone. Before John, 60, left his job as president of Harland Printed Products in Decatur, Ga., in February, he and Martha, 59, made a list of common goals: commit to volunteer work, strengthen ties to friends and family, maintain a healthy lifestyle, and embark on a "spiritual journey." Yet even they encountered problems once they moved to the other side of the line.

Negotiations

TAKE THE ISSUE of where to live. The two have traded in their Atlanta residence for a pair of retirement homes: a townhouse in Delray Beach, Fla., near Martha's parents, and a five-bedroom 1920s cottage on the island of Southport, Me., close to his family. Up north for the warmer months, down south for the colder sounds like a great idea. But John, who already volunteers for the Maine United Cerebral Palsy and the YWCA in Portland, admits "it's a bit of a challenge getting our travel schedules unified." Martha says: "I can't figure out how you commit to friendships, or to important volunteer commitments, and then pick up and say: 'I'll be back in six months.'" Eventually, she may just spend more time in Florida than her husband.

The Healds also had to adjust to sharing space at home. During his business years, John traveled a lot, and Martha ran the house. In the early days of their retirement in Delray Beach, they set up a shared office with a single computer. "This lasted until the first time John saw me at the computer and said, 'this is not going to work,'" Martha says. Now they have separate workspaces and computers on different floors in both houses.

During his working years, John was rarely available to help with household chores. Now that they're both at home, Martha cooks "more meals than I ever dreamed. We're here for breakfast, lunch, and dinner." John does his own wash and takes clothes to the cleaners. But she admits to feeling that "my job hasn't changed all that much. I haven't retired from shopping, cooking.... We haven't really talked about all that." John agrees they need to resolve the issues.

If you and your mate don't give thought to such matters, says Moen, the worst-case scenario is the marriage can break up or fall into a state of constant conflict. The best case? Says Moen: Negotiate the terms of this new phase of your life, because "retirement is more enjoyable if you do it with your spouse."

A Wider Bull's-Ey

» Target funds, which reshuffle assets as you ag are adding more ways to play. BY LAUREN YOUNG

TARGET MUTUAL FUNDS have some new arrows in their quivers. In the past these retirement-savings funds have mainly invested in stock, bonds, and cash. Now at least 10 of the 22 companies that offer these funds are bringing more asset classes into the mix, inc ing real estate investr trusts (REITs), Treasur flation-Protected Secu (TIPS), commodities, emerging-markets deb

Target funds are fu of-funds that work like If you plan to retire in 2 you invest in a 2025 po lio, and as you age, the gradually becomes risky, mainly by sub bonds and cash for sto

Now, with a large vestment palette, r agers of these funds they are able to enhanc versification, boost formance, and comba flation without taking on additional "We could put a kitchen sink in t funds," says Jonathan Shelon, co-r ager of Fidelity Freedom funds, a s of target funds. "But you don't wa diversify for the sake of diversificati

In April, for instance, Fidelity In ments, which manages $50 billion o $87 billion in target portfolios indu

Beyond Stocks and Bonds

TARGET FUND FAMILY	ASSET CLASSES USED	WEB SITE
AllianceBernstein Retirement Strategies	REITs, TIPS	alliancebernstein.c
American Century Livestrong	REITs, TIPS	americancentury.c
Barclays LifePath	REITs, TIPS	barclaysglobal.con
Fidelity Freedom	Commodities, REITs, TIPS	fidelity.com
Hartford Target Retirement	TIPS	hartfordinvestor.co
JP Morgan SmartRetirement	Emerging-markets debt, REITs	jpmorganfunds.co
MFS Lifetime	Emerging-markets debt, TIPS	mfs.com
Principal Investors Lifetime	Preferred stocks, REITs, TIPS	principal.com
Russell LifePoint	REITs	russell.com
Seligman TargetHorizon	REITs, TIPS	seligman.com
Vanguard Target Retirement	TIPS	vanguard.com

Data: Financial Research Corp., *Busine*

Mission Control

wide, added Fidelity Strategic Real Return fund to the Freedom funds. Strategic Real Return, whose goal is to beat inflation, invests in TIPS, commodity-linked notes, and REITs. Allocations among the Freedom funds range from 1% in the longest maturities to 7% in the soonest-to-mature.

Fund managers are putting more diverse assets into the target portfolios because there are more options available. REITs aren't new, but TIPS were introduced only about 10 years ago, and managers don't like to adopt new assets until they can see a track record. Still, a few are moving gingerly. At least nine fund companies use TIPS in target funds, and eight use REITs.

Next Frontier

BARCLAYS GLOBAL INVESTORS, which manages $10 billion in target fund assets, offers both. In January, Barclays added a real estate and a TIPS index fund to its LifePath portfolios.

Real estate doesn't move in tandem with the stock market. That makes it valuable in a multi-asset portfolio, says analyst Greg Carlson at fundtracker Morningstar. "It certainly doesn't hurt that real estate has performed very nicely over the past five years," Carlson notes. No fund company is allocating more than 10% of an underlying target-date fund to real estate investments; an allocation above 20% would raise red flags, Carlson says. The reason for adding TIPS is inflation protection: Their payouts, if held to maturity, increase with the consumer price index.

While firms are dabbling with emerging-market debt and preferred stocks, fund companies have stayed away from pure-play commodities investments. But commodities may be the next frontier. They intrigue Jeffrey Tyler, co-manager of American Century's Livestrong funds. "Commodities are a great uncorrelated asset class," he says. Tim Kohn, a defined-contribution specialist at Barclays, which also is one of the biggest money managers of exchange-traded funds, says he would like to see a commodities ETF in the LifePath funds.

Since target funds started incorporating new assets so recently, it's too soon to tell what effect they've had on performance. Then again, these funds are meant to be steady performers, not shooting stars. Says Carlson: "No one is going to get scared out of these funds because of the volatility."

When the Dips Don't Matter

» BY AARON PRESSMAN

Inflation has been hurting bond prices this year, but inflation-protected bonds have gone down in price, too. What's the deal? It turns out that while Treasury Inflation-Protected Securities (TIPS) get added payments to compensate for inflation, that cash comes only when the bonds mature. In the meantime, they pay less interest than ordinary Treasuries.

Even so, financial advisers recommend that investors put a portion of long-term savings into inflation-protected securities. Despite short-term price swings, they are the only investment guaranteed to beat inflation over the long term. They're also one of the only asset classes, along with commodities, that tend to move in the opposite direction of the U.S. stock market. Owning TIPS for diversification can thus improve your portfolio's returns and dampen volatility.

This protection comes in a variety of instruments (table). The U.S. Treasury sells TIPS in 5-, 10-, or 20-year maturities directly to investors through treasurydirect.gov. The Treasury also sell "I bonds" that accrue interest and an inflation adjustments for up to 30 years. they do with ordinary savings bonds, investors receive the accumulated intere when they choose to redeem.

There are TIPS mutual funds, too, but investors bear management fees which run, on average, about 1%. Since pricing anomalies do crop up, "a good manager should be able to outperform through bor trading even after expenses," says Jonathan Satovsky, a senior planner at Ameriprise Financial in New York. But fun can lose money, too—in fact, TIPS funds lost, on average, about 2% in the first six months of the year. And unlike the securities they buy, the funds never mature and thus can't guarantee they'll beat inflation.

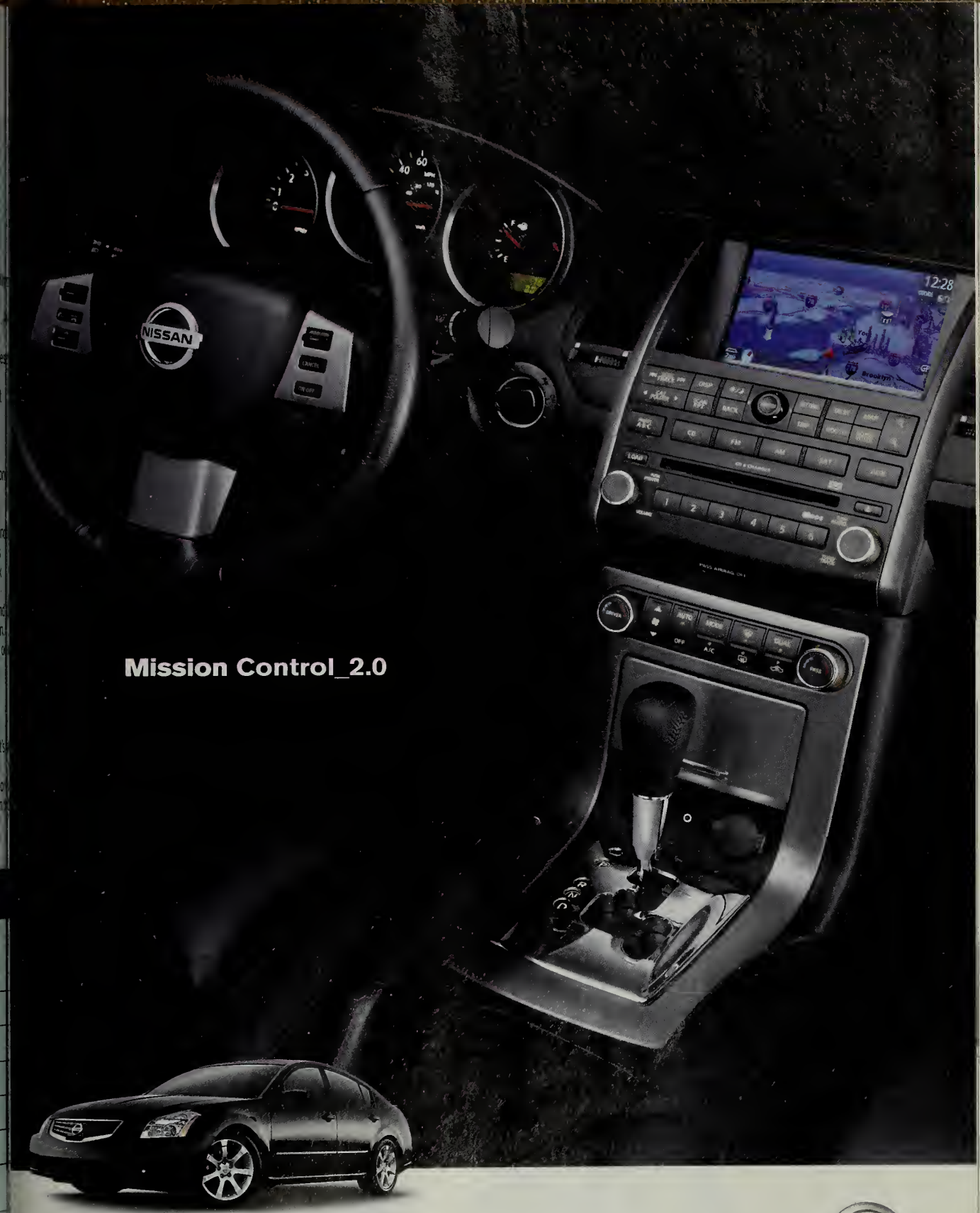
The vehicle you choose may depend o your tax situation. Investors owe taxes every year on both the interest they get from TIPS and the accrued inflation adjustment that won't be paid until maturity. In a tax-deferred account, that's not a problem. But I-bonds are the only taxable-savings product that lets investo defer all taxes until they redeem the bon Beat inflation and hold off the taxman? Not a bad deal.

Tips on Buying TIPS

	U.S. Treasury Inflation-Protected Securities	U.S. I Bonds	Mutual Funds	iShares Lehman TIPS Bond Fund
MATURES	5, 10, or 20 years	Up to 30 yrs.	Never	Never
ANNUAL EXPENSES	None	None	1.01%*	0.20
COMMISSION	None	None	None**	Yes
INTEREST PAID	Biannual	At redemption	Quarterly	Monthly
INFLATION ADJUSTMENT	At maturity	At redemption	Quarterly	Monthly
TAXES DUE ON INTEREST	Annually	Annually or at redemption	Annually	Annually
TAXES DUE ON ADJUST.	Annually	Annually or at redemption	Annually	Annually
AUTOMATIC REINVESTMENT	No	Yes	Yes	No

*Average **For no-load funds. Load funds have sales charges

Data: *BusinessWeek*



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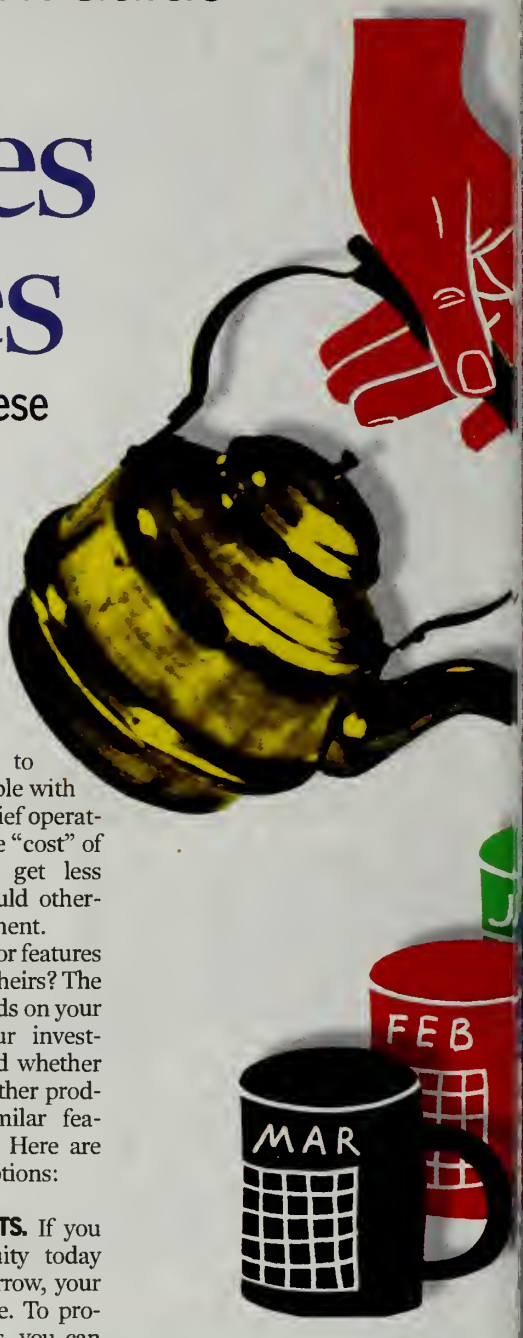
New Wrinkles For Annuities

» Insurers have designed features to make these policies more tempting. BY ANNE TERGESEN



IMMEDIATE FIXED ANNUITIES convert a lump-sum payment into guaranteed monthly income for life, something that should make them attractive to retirees worried they'll outlive their money. But they're not as popular as you might think, since many retirees also worry about the reverse: that they'll die before they collect much of the money, effectively making the insurance company, not their children, the heir.

That's why insurers are coming up with features to make them more palatable. One allows your heirs to receive years of income if you don't live to collect it. Another boosts payments to keep up with inflation. If you need cash, some companies allow you to withdraw part of the value of your account at certain times. New York Life, for example, lets you take back as much as 30% of future payments at five-year intervals or in case of losses because of a fire, flood, or other natural disaster. You can lock in lifetime payments that start at a future date—say, when you're 85—for a fraction of the cost of an annuity that starts paying immediately.

One plan gives a monthly payout to your heirs if you don't live to collect. Another one keeps pace with inflation

"We're designing products to help people get more comfortable with annuities," says Ted Mathas, chief operating officer at New York Life. The "cost" of many of these benefits: You get less monthly income than you would otherwise for the same up-front payment.

Is it worth giving up income for features designed to protect you or your heirs? The answer depends on your priorities, your investment mix, and whether you can buy other products with similar features for less. Here are some of the options:

DEATH BENEFITS. If you buy an annuity today and die tomorrow, your money is gone. To protect your heirs, you can

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n annuity that continues monthly pay-
ts after you die for whatever remains of
contract's first 5 to 20 years. (You pick
riod.) New York Life also has a product
guarantees your heirs the difference be-
n what you paid up front and what you
ived in income by the time of your
h. Another pays a death benefit regard-
of when you die. Is this worthwhile?
may be better off with a regular annuity

plus a life insurance policy for your heirs, says Shane Chalke, CEO of Finetre Corp., which processes sales orders for annuities. For example, if a 65-year-old New York man puts $500,000 into an annuity with 10 years of guaranteed income, he'd pocket $41,328 a year for life, vs. $42,996 with a regular annuity.

Suppose the man takes the higher amount and plows the after-tax difference between the two (about $1,168 for someone in the 30% marginal tax bracket) into a 10-year term life policy. Then he could buy $212,000 in coverage, all of which will go to his heirs free of income tax. With the income-protected annuity, his heirs would receive a maximum of 10 years of income, or $413,280, paid out in annual installments of $41,328. The potential payout would decline by $41,328 for each year the man lives. So if he dies in year five, the heirs would get $41,328 a year for the five remaining years, or $206,640 in total. Because the man is relatively young, combining a regular annuity and a life insurance policy is likely to prove the better deal.

INFLATION PROTECTION. To keep rising prices from eroding your purchasing power, you can elect to receive an annual raise of 2%, 3%, or more. With Vanguard Group's Lifetime Income Program, you can choose to have your income adjusted once a year for inflation. But to get a 3% annual raise, the 65-year-old above would receive $31,780 the first year, vs. more than $42,000 with a regular annuity. It's only if he lives beyond his life expectancy of 82 that he will come out ahead by choosing the 3% raise, says Hersh Stern, publisher of *Annuity Shopper* magazine.

If you opt against inflation protection, make sure your portfolio contains assets, such as stocks, that typically grow faster than inflation, advises Ellen Rinaldi, principal at Vanguard. To make sure your portfolio has adequate diversification and liquidity, put no more than 30% into annuities, she adds.

INTEREST RATE PROTECTION. The higher rates are when you buy an annuity, the higher your payments will be. If you think rates are heading up, consider putting some money to work now and more later. You can also buy a New York Life product that provides a one-time, 20% step-up in income on the policy's fifth anniversary if 10-year rates are two percentage points or more above where they were when you bought the annuity. To get this, you'll sacrifice 2% of your monthly income.

LONGEVITY PROTECTION. Suppose you're confident you have enough money for your 60s and 70s, but are worried about your 80s and 90s. You can buy "longevity" insurance by paying now for an annuity that starts payments years from now when you really need it. Sure, you may never collect—but you're not putting out a huge sum, either. To get an annual income of $42,000 from age 85 on, a 65-year-old man would put down just $47,575 today, vs. $500,000 for an annuity that starts paying $42,000 now. Moreover, knowing how much income will kick in at 85, a person can spend more money during the next 20 years.

If you're worried about dying before your benefits start, MetLife offers a version that refunds heirs your investment plus annual earnings of 3%. But a 65-year-old man who puts down $100,000 would get just $49,080 a year starting at age 85, vs. $84,000 without the death benefit.

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Sun microsystems share

Beyond Florida and Arizona

Wisconsin, Idaho, and Georgia may not sound like paradise. But maybe you just haven't looked

STORYBOOK VILLAGES, quaint harbors, and a thriving arts community make Door County, Wis., a cozy spot for retirees. But for adventurous people like David E. Nevalainen, there's lots more: plenty of land—Nevalainen built a 3,000-square-foot log home on 70 mostly wooded acres with two private ponds—opportunities to indulge such hobbies as blacksmithing and target-shooting, and intriguing folks with whom to socialize.

Nevalainen, 62, and his wife, Jean Barrett, 55, moved to this bucolic peninsula jutting out into Lake Michigan in 2000, two years after he retired from his post as a scientist with Abbott Laboratories. They began vacationing in the area in 1986, bought their land for $150,000 in 1997, and built their home two years later. "We designed a house for two people to grow old in," the PhD hematologist says. The county, a five-hour drive north of Chicago, offers Nevalainen enough privacy for "skinny-dipping in the pool" and enough civilization to please a fan of symphonies and Shakespeare. For Minnesota-bred David and urban New Englander Jean, "it's an ideal combination."

Vacationers from the Midwest have long been drawn to Door County's boating, golf, and hiking, as well as such novelties as fish boils (featuring whitefish cooked the way Scandinavian settlers liked it over a century ago). Summer vacationers can triple the population to more than 84,000. Now more retirees are finding it a choice spot, too, whether they come only for the warm months or hunker down for the winters.

Year-round, there's no shortage of things to do. Want to learn about ravioli-making, wood carving, or Nordic music? Take a class at The Clearing folk school (theclearing.org), a 71-year-old educational facility on a forested 130-acre site. In warm weather you can choose from concerts conducted by Victor Yampolsky, director of orchestras at Northwestern University, or a play by the Bard at Door Shakespeare. You can hike through five state parks, or check out 300 miles of shoreline, 10 lighthouses, and 11 golf courses (doorcounty.com).

For many retirees, such activities take a back seat to community-minded pursuits. Jim Kinney, 60, a former bank chief financial officer who dabbles in real estate, is involved with a land trust group to preserve open space.

While property costs have shot up in recent years—land goes for $3,000 to

PHOTOGRAPHS BY JAMES SCHNEPF; MAPS BY LAUREL DAUNIS ALLEN/BW

DOOR COUNTY, WISCONSIN
Retirees like Jean Barrett and David Nevalainen are drawn to the peninsula by its natural beauty—with 300 miles of coastline and 10 lighthouses—but also its thriving cultural life

TURN BACK THE CLOCK
New residents, many from California, are flocking to Sandpoint for its slower pace and more affordable housing

$4,000 an acre—a spate of condo development has put more real estate within reach. Condos can be had for under $300,000, although waterfront views can jack up prices above $1 million. Apartments for the elderly as well as assisted-living facilities can also be found in Sturgeon Bay and Sister Bay. *–Joseph Weber*

Sandpoint, Idaho

FIRST-TIME VISITORS TO SANDPOINT realize they have entered another world when they cross the bridge that spans the glacier-blue expanse of Lake Pend Oreille. It's there they catch a glimpse of the charming town nestled beneath the mountains of northern Idaho. "It's like turning back the clock 40 years," says mortgage broker Steve Kirby, who moved from San Diego to Sandpoint last year and plans to retire there soon.

Irritated by rampant growth in California, Kirby chose Sandpoint for its natural beauty and recreational opportunities. He now has a waterfront home, which he could never have afforded in San Diego. "The town itself is a real town," Kirby says. "It's not like a Tahoe that was created as a resort."

Sandpoint outgrew its roots in timber and mining and fully embraced tourism several decades ago. With the Schweitzer Mountain ski resort just 12 miles away and a lake that offers boatloads of recreational opportunities, Sandpoint has long attracted outdoor enthusiasts. It has been northern Idaho's one relatively liberal, funky outpost, in contrast to the right-wing militias and neo-Nazis who once hunkered down in nearby Hayden Lake.

Affluent retirees and second-home owners from the West and as far away as Louisiana have begun flocking to the town and surrounding Bonner County. "Most of the influx is from California, and what brings us up here is the price of housing," says semiretired Stephen Hoag, 56, who left Paso Robles, Calif., for Sandpoint in 2004, when the last of his kids turned 21. His three-bedroom, 3,000-square-foot house sits at the bottom of the mountain and overlooks the town lake. It cost him $340,000 three y ago; he says he could sell it nov $420,000.

This appreciation is part of a tren around Sandpoint. The median h price is $220,000, up from $121,5(2002, according to the Selkirk Associ of Realtors. Since 1990 the county p lation has increased by more than 5(about 41,000. Two golf courses are t planned, and golfer Jack Nicklaus is ing a resort just east of town and tur it into a private club. Another group i ing to improve the airport so it can b handle landings in bad weather, wh new Chamber of Commerce committ working with local merchants to r their services more elder-friendly by proving access to shops.

While retirees don't often seek climes, the locals jokingly refer to u Idaho as the "banana belt" on accou its low altitude and relatively mild mate (average January high: 32, an snowfall: 70 inches). "We're in late dle age, and living at 2,000 feet is easier than living at 9,000 feet," Doris Sanger, 55, a former Denver dent who, with her husband Ken, considered the Colorado Rockies be opting for Sandpoint.

More than just a town for na lovers, Sandpoint also offers classic

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"GARDEN OF EDEN" Scott and Gail Ledbetter had vacationed on Island for years before building their home the (below) in 200

shows, art galleries, restaurants, wine tastings, and plays and movies at the historic Panida Theater, which will host the first Idaho Panhandle International Film Festival next month. "There's almost always something happening that's culturally interesting," Sanger says. "When you get here, it's like going to a giant house party." And everyone is invited.

–Stanley Holmes and Greg Hafkin

Sea Island, Georgia

LAZY ATLANTIC OCEAN WAVES LAP ITS wide beaches. Mansions dot its winding lanes. Residents and guests often sip cocktails at its renowned hotel, The Cloister, designed in the 1920s by architect Addison Mizner, who built Palm Beach, Fla. When retirees aren't socializing here, they might be slipping out for target practice at the shooting range or playing a round of golf at one of three world-class courses.

For retirees with deep pockets, Sea Island could be Mecca. For decades the five-mile-long fingerlet halfway between Savannah and Jacksonville, Fla., has been known as "Millionaire's Island." The residents of its 700 "cottages" include a hefty share of CEOs, politicians, and artists who can afford the $3 million average price of a home. Last year the former home of playwright Eugene O'Neill, a 6,000-square-foot Mediterranean-style villa, sold for $20 million. "This place has a civility and genteel nature about it that I don't think you can find anywhere else," says J. David Everett, president of Sea Island Co., which owns the island and 800 yet-to-be-developed acres on neighboring St. Simons Island. (If developed, Sea Island Co. says it will build low-density residential communities.)

Residents say retiring to Sea Island keeps both the mind and the body active. On the first Monday of each month, 20 longtime residents attend the invitation-only Sea Island Roundtable to discuss finance, politics, books, and current events. It is one reason Sea Island is a cut above traditional retirement locales, says Reg Murphy, 72, vice-chairman of the National Geographic Society and a member of the Roundtable. "It's the kind of place people come to who don't want to retreat into golf, television, and lazine

Such stimulation helped entice Ledbetter, 55, to head south perman after vacationing on Sea Island for y In 2004, nine years after selling Greenwich (Conn.) cable company lumbia International, to TCI (late quired by Comcast) for $580 million, better and his wife, Gail, 53, bu 6,000-square-foot, four-bedroom h in Sea Island's Ocean Forest neigh hood. Now, Ledbetter, who says he i retired but living "a new chap spends his outdoor time running o beach and sailing, while indoor tir dedicated to private investing. "I morning my wife and I wake up in seems like an earthly Garden of Eden says. It's a garden where the apple tasty—but expensive. *–Brian*

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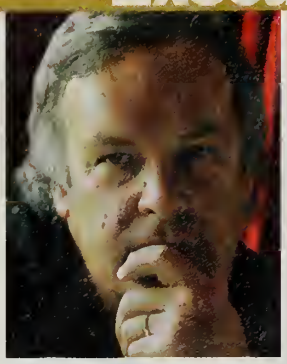

BY ROBERT PARKER

From Spain, Crisp Summer Wines

SPANISH WINES ARE LITTLE-KNOWN in the U.S., which helps to explain why the prices are low given the quality of the product. If you're not familiar with them, it's time give them a try. Do you enjoy crisp white wines? The pick up a bottle of albariño or verdejo. For festive occasions, pop the cork on a bottle of cava, Spain's sparkling wine. What about Spain's fabulous red wines? That's next week's column.

Bodegas Nekeas 2005 Vega Sindoa Viura Chardonnay
87 points. Fermented in stainless steel tanks, this blend (70% viura, 30% chardonnay) is an amazing effort. Crisp, elegant, and dry, with a fragrant, viognier-like bouquet, it offers abundant quantities of tropical fruits (pineapples), medium body, fresh, pure flavors, and a zesty finish. Drink over the next 8 to 12 months. $7

Telmo Rodríguez 2005 Rueda Basa Blanco
87 points. Light-bodied and dry, this wine mimics a New Zealand sauvignon blanc. Completely fermented and aged in stainless steel tanks, this aromatic blend of sauvignon blanc, viura, and verdejo reveals abundant fruit, beautiful crispness, and a zesty personality. Enjoy it over the next 12 months. $10

Mont-Marcal 2001 Cava Brut Reserva
88 points. A light-straw-colored, light-bodied sparkler that has a good, frothy effervescence. It also has attractive pear and tropical fruit characteristics and a dry, soft finish. Drink it over the next 12 to 18 months. $12

Burgans 2005 Albariño Rías Baixas
88 points. With a medium body as well as wonderfully crisp orange marmalade, mineral, and flowery tropical fruit notes, this wine makes an ideal accompaniment for seafood and shellfish dishes. $12

Bodegas Naia 2005 Naia
88 points. This tank-fermented and aged verdejo offers loads of honeysuckle, lemo zest, and orange-rind traits in a crisp, me bodied, surprisingly textured yet elegant, style. Drink it in 12 to 18 months. $13

Gramona Gessamí 2004
90 points. An intriguing blend of 60% mu de Alexandria, 30% sauvignon blanc, an 10% muscat de Fontignac. Exotic waxy n intermixed with notions of rose water, aca flowers, and minerals jump from the glas this medium-bodied white. It possesses fruity, dry, intense, pure, spicy personalit word gessamí originates from the Hebre word for jasmine, but I did not detect tha characteristic in the wine. Drink it over th next year. $13

Cava Avinyó nonvintage Brut Reserva
89 points. A fruity, soft, medium-bodied sparkler with a frothy effervescence as w hints of pear, honey, and peach. Enjoy it c the next 1 to 2 years. $15

Visit **www.eRobertParker.com** for the Internet's most active wine bulletin boa tens of thousands of tasting notes, or t order his recent book, *The World's Grea Wine Estates: A Modern Perspective*. Y can also subscribe to Parker's newslett *The Wine Advocate*. Request a sample copy at: *The Wine Advocate*, P.O. Box 3 Monkton, MD 21111.

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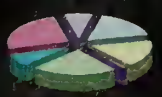

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Spyware Inc.

No surprise: Readers had few kind words for pop-up advertisers and their ilk

BY JAMES E. ELLIS

For most of us, certain things are considered sacred: Home. Family. Car. And, in today's increasingly wired world, our computers. So it was no surprise that *BusinessWeek*'s Cover Story about adware giant Direct Revenue, "The Plot to Hijack Your Computer" (July 17), struck a nerve with many readers. This tale and the accompanying package of stories about the multimillion-dollar industry that toils to secretly track your movements across the Web while planting unwanted pop-up ads on millions of PCs led more than 160 readers so far to voice their opinions by either e-mail or snail mail.

Besides the basic outrage, by far the most spirited debate revolved around whether adware-weary computer users should abandon their Windows machines for PCs running the Linux operating system or Macs, which have been less targeted by the malware industry. Online reader JohnD echoed the sentiments of many Apple devotees when he wrote: "My anti-spyware program: Macintosh OS X. After you get a Mac, it's almost fun to watch all the Windows users pulled over to the side of the information superhighway for repairs."

But online reader Xarn notes that the problem is not that simple. "Of course, spyware [today] is only for Windows [because] Mac users are still very marginal, so why bother?" he writes. "If—and that's a big if—Mac one day becomes the dominant PC platform, trust me there w plenty of spyware for it."

There was far more reader agreement that many victims of spy are in part to blame for their predicament because they are so eag download "free" software or music that they often fail to peruse th customer agreements that go with them. "There is no such thing a 'free,' especially on the Internet," explains online reader Ron_C. "If says free, it's guaranteed to have something attached. *Caveat emp*

Although readers almost unanimously likened malware makers the spawn of Satan, one respondent found a surprising silver lining the miscreants' devilish handiwork. "These are brilliant programm looking to take advantage of the normal Web user's ignorance and looking for the quick buck," wrote online reader bobgoldschmidt. "However, remember that virtually all of today's e-commerce technologies originated from the early Internet pornography indus which 'good' people bemoaned, but ultimately benefited from. I su that the technologies developed by the Dark Arts team and similar groups will eventually find their way into legitimate uses."

That may be wishful thinking. But if today's PC hijacking technic could beget tomorrow's remote management technologies to mak computers easier to use, then perhaps all is not lost. In the meanti here's a sampling of what other, less sanguine readers had to say:

The Web is the hottest game in advertising, but what's rarely acknowledged is the extent to which unsavory pop-ups boost the returns.
–from "The Plot to Hijack Your Computer"

I think it's outrageous that we spend over $2 billion dollars a year just to get rid of something that nobody asked for in the first place. It's a bit like me sitting down for dinner in my home and suddenly an intruder breaks into the front door, demands to be included at the dinner table, and then refuses to go away unless I pay him. And even if I do pay, he remembers my address and then sells it to other intruders. Where does this stop?

> *Will Robertson, Vice-President for Sales*
Market Scan Information Systems Inc.
Westlake Village, Calif.

People like those in the "Dark Arts" division are why I don't allow myself to own a gun. The amount of resources, time, and money wasted by them is unfathomable, and they show no remorse whatsoever—like it's their right to do this to machines they don't o

> *Afreyt, posted*

I've been fighting for weeks to remove a rootkit invader from Web Nexus Networ no avail. These spamazoids are ruthless insidious. If our feds want to really do something to earn their keep, then they ought to get after these privacy thieves. no, I don't want to kill them. I just want t to have to sit in front of an infected com for eight hours a day for the rest of their

> *Capt. Trips, posted*

We're concerned about terrorists attack us through bombs and other such devic [But] these people are terrorists of the kind, attacking and disabling not just a couple hundred or a few thousand

outers. Guantánamo would be too good
ce for people like Direct Revenue's
ders, investors, and employees.

> Dave, posted July 8

d we see pictures of these people?
eone should create a Web site where the
rs and employees of these
inesses" are exposed. They're
ic Enemies, after all.

> RP, posted July 10

> Nearly three-quarters of
> all sites listed in response
> to Internet searches for
> popular phrases like
> "digital music" attempt
> to install some form of
> advertising software in
> visitors' computers.
> –from "The Plot to Hijack
> Your Computer"

e's no reason to put up with any of this.
simple solution: (1) throw out your PC
erably from a height of eight stories or
e), (2) get a Mac, (3) download Firefox
make it your default browser.

> Carol Georgopoulos, Albuquerque

ng simple precautions to protect your PC
nilar to using common sense in general:
t put yourself at risk [by] walking across
k parking lot in a bad neighborhood
e at night, and use a condom with
gers [during] sex. While there is no
fire way to avoid trouble, a little thinking
some basic software help reduce the
to a minuscule level.

> Rick Cunnington, Oro Valley, Ariz.

e had my Windows machine running for
years and no problems at all. The secret?
not install junk. This is the reason Mac
users do not have many problems—there's not much software (and respective junk share) available. It's not the OS, dude. It's you.

> Fred, posted July 10

Imagine watching your favorite TV show and a vacuum cleaner salesman popped up in front of you and tried to sell you a machine. You would never buy from him. Do the same for pop-ups, and they will disappear.

> J.R., posted July 8

Taking advantage of PC users' ignorance about the inner workings of their machines is akin to a doctor deliberately misprescribing a drug that causes cardiac failure—[it's] O.K. because the patient should have known he had heart disease. It's interesting about computers as products: No one takes responsibility for anything going wrong, even when damage is deliberately planned. You wouldn't do the same for burst pipes. Why give the computer industry special dispensation to screw up?

> Bob Jacobson, July 8

Some readers are blaming the victims for thinking they could download free software without any consequences. This reminds me of the attitude that it was Nicole Simpson's fault she was murdered—after all, she had the resources to move to another city. Let's stop blaming the victims. People have the right to live in their hometowns without being murdered, and they have a right to accept free software without being subjected to cyberterrorism.

> Rohricwl, posted July 8

You don't want spam? Don't give out your e-mail address. You don't want pop-ups? Then buy the software legitimately for $30. Oh, and there is a reason they make you click on "I agree" in the licensing agreements. Regardless of whether you read it or not, you have just given that company permission and access to your computer!

> nothings for free, posted July 8

This is not about Mac vs. PC. This is about ethical vs. not—that there are people in this world who think nothing of ruining your property for their profit. That, my friends, is the issue.

> John:D, posted July 7

> A new generation of spyware purveyors of equal or greater potency is imitating Direct Revenue's strategies, infuriating customers and threatening to taint the larger business of online advertising.
> –from "The Plot to Hijack Your Computer"

I work for one of those seemingly "ineffective" A/V [anti-virus] vendors that were mentioned, and I can tell you that in the vast majority of adware/spyware infections, the users are manually installing the stuff themselves. Sure, they don't read the fine print, but anyone who still believes that you get something for nothing these days is living in dreamland. And expecting your anti-virus/anti-spyware software to come to your defense is a little like driving a car blindfolded and expecting your air bag to protect you.

> Jack, posted July 9

To read the full report and related information, go to the link listed below or visit www.Finance-Insights.co

Evaluating Your Financial Health

Have you had a check-up of your financial health recently? Like an annual physical from your doctor, a regular review of your financial health is important. You can give yourself a check-up by reviewing the four basic strategies of a healthy financial condition: accumulating savings, managing debt, preserving assets and distributing assets. Keep score as you go along.

If you have defined your savings objectives, from retirement income to remodeling the kitchen, and created a family budget, give yourself 2 points. These steps help provide a road map to achieving your objectives. If you are maximizing the power of your savings by taking advantage of tax-deferred vehicles such as your company 401k or IRAs, give yourself 3 points. If you have savings beyond these vehicles, you are ahead of the game. Give yourself 4 points.

Debt is a steep impediment to accumulating assets. If you have no continuing credit card balances or loans on depreciating assets, such as a car, give yourself 2 points.

What if you can no longer earn your income? Life, disability and long term care insurance should be part of your asset preservation strategy. If you have reviewed your insurance needs and have adequate insurance in plac yourself 2 points.

A distribution strategy includes creating health care advance directive and power ney. Review your existing accounts, poli company benefits to ensure titles and ber designations are correct. Consider trusts a ing plans to minimize estate taxes. If you l right documents in place, have reviewed yc and beneficiaries and considered your tr gifting options, give yourself 3 points.

If your score is less than 12, you hav work to do. Good financial health wi you to pursue your life's dreams with dence. A check-up now and then can h achieve and maintain it.

To read the full report, go to www.finance-insights/stancorp.asp

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Professional Disciplines – An advisor with multiple disciplines, such as tax, investment and insurance, is better suited to lead an estate team than a single disciplined advisor.

Track Record – Years providing estate planning servic es? Demonstrated success through economic cycles?

Client Base – Number of active clients?

Testimonials – Reputation with past and preser

Network – Can advisor access the best pr als in the country? Will advisor customize t team to suit the client?

Internal Resources – Does advisor have capability to analyze tax, legal, investmen ance, foundation and charitable concepts?

Transparency of Fees – Will advisor provide closure and explanation of fees associated professionals on the estate team?

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To read the full report, go to www.finance-insights/chamberlain.asp

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A: New Implications for Estate l Long-Term Care Planning

Deficit Reduction Act of 2005 (DRA), by President Bush in February 2006, aims e government spending by cutting federal d funding. Included in the DRA are provi- tighten Medicaid's long-term care eligibili- rements, which shift the responsibility for ong-term care costs away from the govern- d back onto the individual.

e families will most likely feel the DRA's affect ir bank accounts. Narrowed Medicaid eligi- idelines will leave more people faced with ong-term care expenses out-of-pocket at a en nursing home costs continue to rise.

Retirement planning tools, such as long-term care insurance plans, may be appropriate for those concerned about draining their retirement savings and other investments. Consulting an insurance agent or financial advisor about these important changes is recommended.

Consumers also should be familiar with the DRA changes to eligibility guidelines for Medicaid nursing home benefits that affect asset transfers and the treatment of home equity and annuities.

The Medicaid penalty period, or look-back period, has been extended from three years to five years for individuals that transfer assets at less than fair market value (divesting assets, giving cash gifts or transferring mortgage titles to family). The look-back period effective date now begins on the date of the Medicaid application, not the date of the asset transfer, which can limit transfers pre-planned solely to create a Medicaid qualification.

Under the DRA, treatment of home equity and annuity transfers are no longer exempt from penalty period consideration. Medicaid applicants with more than $500,000 in home equity may now be ineligible for long-term care benefits, as determined by individual state guidelines. Asset transfers to annuities are currently prohibited during the look-back period except when the state is listed as the annuity's named beneficiary for at least the amount of the Medicaid benefits provided.

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tirement Income: Uncommon proach To Common Question

any retirees and near-retirees, the "golden ften give rise to an unexpected question: ow do I turn my retirement savings into nt income?

e not alone in wondering. Seventy-eight of retirees have no income plan, according to International's Retirement Planning Study,

ommon answers to that question often raise ons. Retirees can opt to invest their nest eggs ual funds and draw on them year after year, e worry that they might outlive their savings. ively, they can purchase a lifetime annuity with a lump sum payment, but some worry that they are giving up flexibility to address future needs.

Now, however, a new approach provides a balance of security, control and flexibility by giving retirees a way to turn tax-qualified retirement savings (e.g. 401(k) and IRA accounts) into inflation-adjusted monthly payouts that last their lifetime -- like a pension, in some respects.

Here's how it works: Working with an advisor, a retiree rolls over tax-qualified retirement savings into an IRA, where the money is invested in mutual funds (whose value will fluctuate with the market over time). A special calculator determines the hypothetical amount of lifetime monthly income those savings can sustain based on such factors as life expectancy, investment amount and survivorship needs.

The retiree then decides how much of that monthly income he or she wants to guarantee through the purchase of an income annuity within the same IRA. Retirees can purchase the guarantee in a lump sum, or, more likely, transfer assets in smaller increments over a number of years from a mutual fund model portfolio to the income annuity. They can stop, speed up or slow down the transfers at any time.

With this program, currently available only through certain investment advisors, the retiree gets the convenience of a single IRA account, a single statement, and a single income check that includes mutual fund withdrawals and annuity payments.

To read the full report, go to www.finance-insights/massmutual.asp

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MassMutual Financial Group is the fleet name for Massachusetts Mutual Life Insurance Company (MassMutual) and its affiliates, with more than 13 million clients and over $395 billion in assets under management at year-end 2005. Founded in 1851, MassMutual is a mutually owned financial protection, accumulation and income management company headquartered in Springfield, Mass. MassMutual is on the internet at www.massmutual.com.

Eat Your Hybrid Veggies

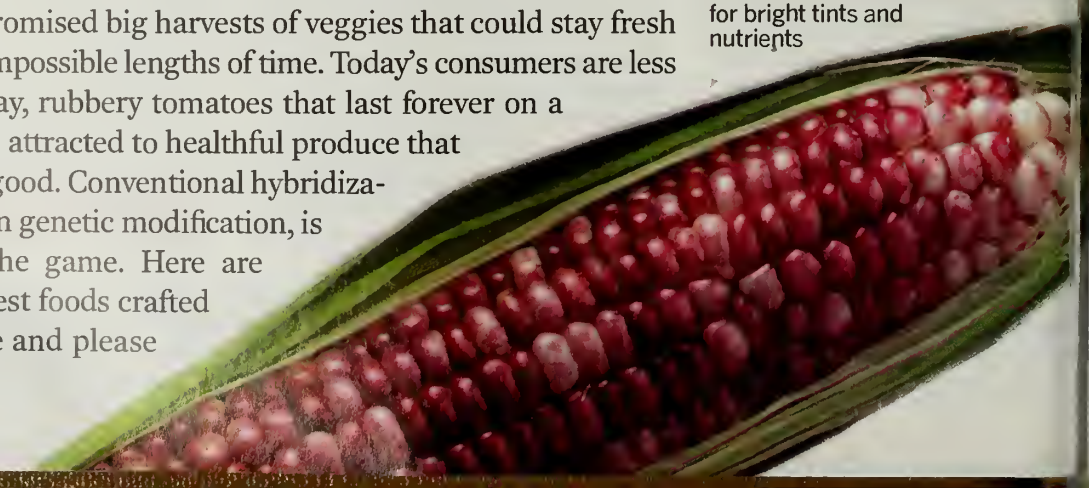
From scarlet corn to tortilla-like lettuce, innovation is hitting the produce section

BY ADRIENNE CARTER

EVEN FOR SHOPPERS USED to the riot of colorful fruits and veggies in a suburban grocery store, a walk through the produce aisle at the Harris Teeter supermarket in Mount Pleasant, S.C., is a feast for the eyes. There are exotic fruits like the kiwanos, with orange skin and white flesh that tastes of banana, watermelon, and cucumber. The spiky fruits are so odd that when they roll through checkout, even the cashiers can't always I.D. them. But also piled high on the shelves are cobs of corn with scarlet kernels that look like old-fashioned wild maize. These are a modern take on so-called "heirloom" varietals. The corn is custom-bred to have high levels of anthocyanin, an antioxidant usually found in red wine and blueberries. Down the way are some funny-looking artichokes—purple, thanks to a similar enrichment with anthocyanin.

Innovation is sweeping through the farm sector, bringing surprises that go beyond exotic fruits jet-shipped from the ends of the earth. In many cases it is consumers who are influencing produce breakthroughs, just as they forced agribusiness to take organic food seriously. Years ago seed companies courted farmers with new seed varieties that promised big harvests of veggies that could stay fresh for seemingly impossible lengths of time. Today's consumers are less interested in, say, rubbery tomatoes that last forever on a shelf, and more attracted to healthful produce that actually tastes good. Conventional hybridization, rather than genetic modification, is the name of the game. Here are some of the latest foods crafted to catch the eye and please the palate.

GROWERS Some 70% of the nation's lettuce is produced in the Salinas Valley on the coast of California. Drive through the area, and you'll see lettuce fields for miles in every direction. Billboards celebrate the major producers, Dole Food Co. and Fresh Express, which have deep pockets and a lock on many supermarket shelves. It's the smaller growers, though, that



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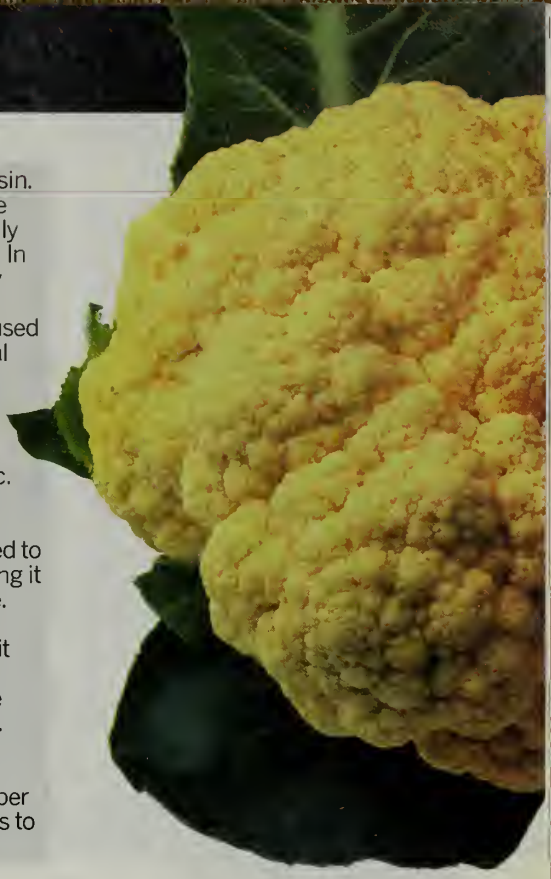

SCIENTISTS These new fruits and veggies aren't being cooked up using genetic engineering. Scientists employ older methods, such as crossbreeding different varieties of the same plant, but with a high-tech spin. To speed the time from lab to grocer, researchers probe the DNA of different varieties to identify traits such as color and taste and to find the fittest seeds to crossbreed. It's still largely a process of trial and error and can take 5 to 10 years to develop a salable product. Inspiration comes from all quarters. Scientists at seedmaker Seminis Inc., a unit of Monsanto Co., enhanced ordinary tomatoes by crossing them with a rock-hard, pea-size wild green tomato from the mountains of Peru that packs plenty of lycopene, an antioxidant that gives tomatoes their deep red color. At Cornell University, researchers mixed a naturally occurring orange-tinted cauliflower with a traditional white variety to make an orange cauliflower now sold by Seminis. The mellow hue appeals to chefs, and it also boasts 25 times more beta-carotene than its pale cousin.

Consumers are wary of genetically modified strains. In the U.S., the only major GM food crops are corn (used mostly for animal feed and corn syrup), soybeans, and canola. In the '90s, Calgene Inc. tried to sell Flavr Savr tomatoes, genetically altered to ripen slowly, giving it a longer shelf life. But flavor and quality are what it lacked, and it flopped. Still, the door isn't closed. Scientists might some day take a gene from a pepper and add nutrients to lettuce.

are carving out new niches by devising specialty varieties.

Stephen Griffin, president of Misionero Vegetables in Salinas, knew the farm his father started would not survive selling bland heads of iceberg lettuce. So last year, along with its organic products and bagged salad mixes, Misionero started selling Lettuce Jammers, a cross between a romaine and an iceberg, created by Seminis.

The oversize boat-shaped leaf is extra durable, yet still crunchy and tasty, so it can be used like a natural tortilla wrap to hold hot foods such as chili or taco fixings.

Sometimes sold under names chosen by grocery stores, the lettuce has been picked up by Wal-Mart Stores Inc. and Loblaws Inc., a Canadian chain.

Another tack is to help shoppers select the freshest produce. The deep grooves in Syngenta's Dulcinea Farms Extra Sweet Tuscan Style Cantaloupe go from dark green to a golden cream color when ripe. "You can't make a buck if you don't have something distinctive," says Griffin.

SEEDMAKERS Producers of seeds used to focus mainly on what farmers wanted to buy. These days, agri-giants such as Switzerland-based Syngenta and Monsanto's Seminis unit also seek input from grocery chains and shoppers. The process can be a tough balancing act. Retailers such as Whole Foods Market Inc. want eye-grabbing items to lure shoppers. But the big distributors that supply fast-food chains and packaged-food makers put a higher value on processability. Seminis has floated the idea of a cylinder-shaped tomato that could help fast-food chains reduce waste from slicing.

Consumers are invited to weigh in. Syngenta grows new crops and regularly convenes consumer panels to harvest preferences directly from those who fill the shopping cart. Syngenta's PureHeart watermelon is the result of trials showing that consumers want sweeter, smaller melons. The PureHeart weighs five to seven pounds —a third as much as regular watermelon.

PAS DE DEUX Cercor and Gladziszewski shared seven jobs a three companies

Two for the Cubicle

Sharing a job is always dicey. How one pair has made it work for 15 years

BY SUSAN BERFIELD

THEY SHARE A TITLE and a salary, a desk, a phone, and an e-mail account. Their résumés are nearly identical: For the past 15 years, Sharon Cercone, 48, and Linda Gladziszewski, 45, have been partners in seven human resources jobs at three different companies. They are now compensation consultants at PNC Financial Services Group Inc. in Pittsburgh, where one executive describes them in a way that might unnerve even the most collaborative among us: "I think of them as a single individual," says Valentine Przezdecki.

Successfully sharing a job is more demanding than pretty much any other flexible work arrangement. Partners have to trust each other with their careers. They receive the same recognition, and if one falters, both take the blame. They have to communicate the details of their days precisely and without fail. Theirs is an intricate pas de deux, requiring a certain familiarity and ease, and like most things in life, it can't be forced. "All of the stars have to be aligned. You have to be able to complete each other's sentences and have a manager who doesn't mind adding another level of complexity," says Kathleen C. D'Appolonia, a senior vice-president at PNC. "When it doesn't work, it is very disruptive, and it can not work for all kinds of reasons. It's sort of like marriage." She says that

Partners have to trust each other with their careers

nearly half of P 25,000 employees some kind of fle arrangement; a tot 12 share jobs.

The decision to s a job is usually th sult of a cool appr of the workplace: the arrangement fers more status th part-time job does the position is full- it's less likely tha contribution will marginalized," say Katepoo, the found WorkOptions.com.

No one has an mate of how r workers share nowadays. But as companies try to r talented women (and men) with y families as well as those baby boo who want more time to themselves number that offer job shares is rising 2005 National Study of Employers b Families and Work Institute found 44% of businesses allow some empl to share jobs; in 1998, 38% did.

CEMENTING THE BOND

SHARON AND LINDA happened t the idea at a time of transition in home and work lives. In the late 19 Mellon Financial Corp., where were full-time compensation con ants, was in turmoil. The bank ha 20% of its workforce and was loo for ways to encourage its most tale employees to stay. After the birth o first child, Sharon proposed sharin job and was matched with an woman. When her partner left Mell teach, Sharon asked Linda, who ha returned from maternity leave wanted more time with son, to apply for the jo October, 1991, they beg work together.

The practice of con communication and in organization that they d oped then remains intac day, though made vastly e by mobile phones and e- Sharon works Mondays Tuesdays, Linda Thurs and Fridays; they alte

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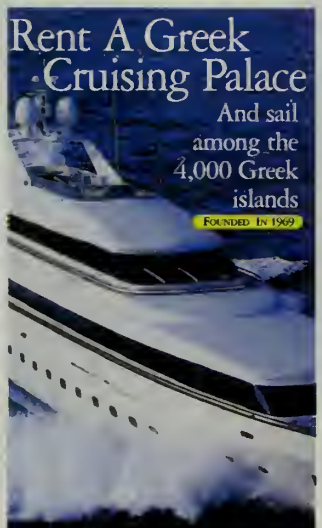

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My Partner, My Self

How to create job security for two

1 BE YOUR OWN MATCHMAKER

You and your workmate have to completely trust each other. It's a long-term relationship, and your company shouldn't be the one to pick your partner.

2 MAKE IT WORK FOR THE COMPA

Present a proposal that provide business rationale, not the pers motivation. Be willing to move t the company where those in cha more accommodating.

Wednesdays. They talk or exchange text messages several times a day, and more often on Wednesdays. They check in at night. They keep project notes and a phone log, and even describe the body language of those with whom they meet. "We overcompensate so people understand that we don't let anything fall through the cracks," says Sharon. "We make references to our notes when talking to others." The back-and-forth can add up to three hours to their workweeks, but, says Linda, "We know the arrangement could end at any time, so whatever we can do, we do." They even schedule face time; colleagues tease them about planning lunches weeks ahead.

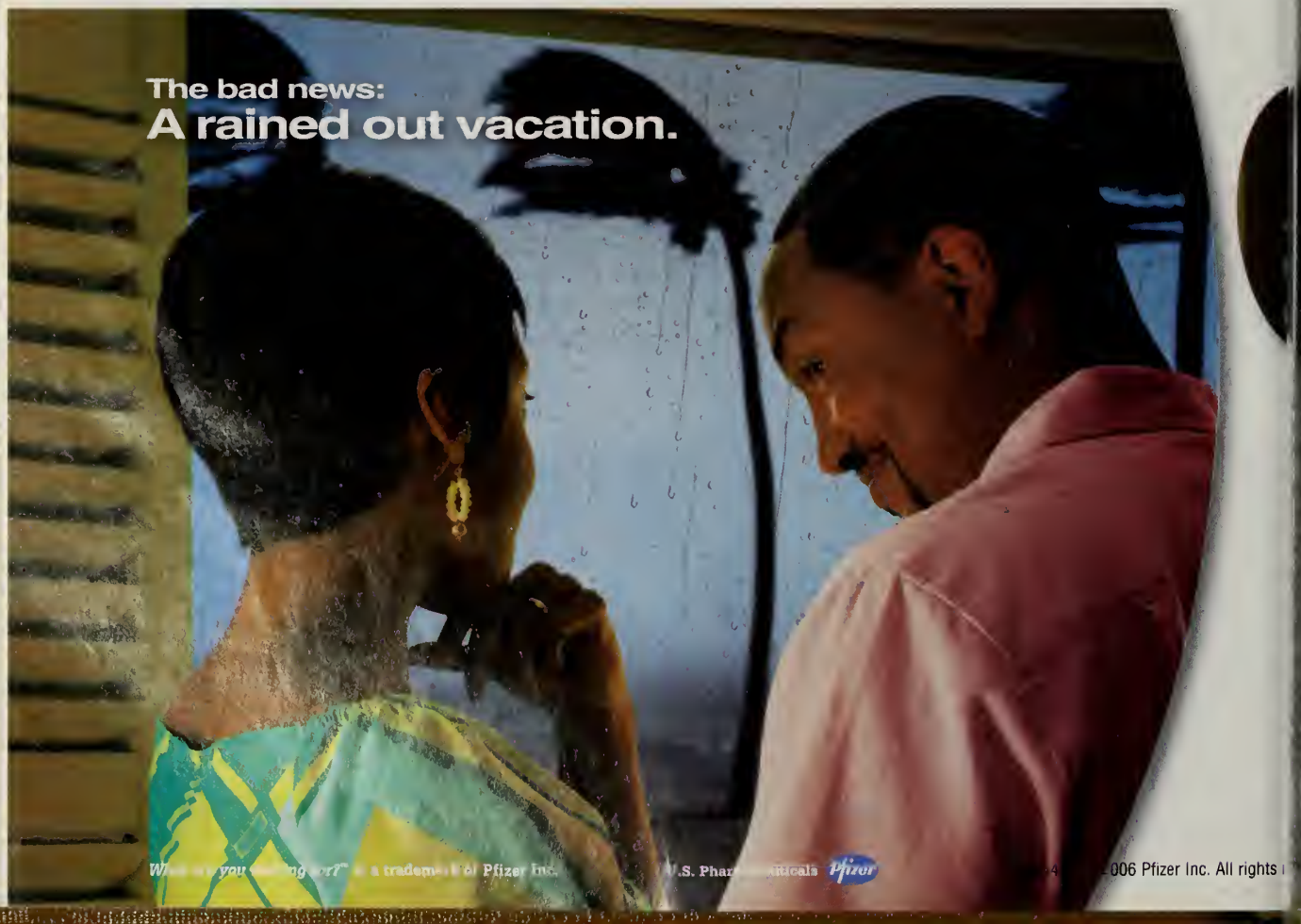
In the early days of their job share, co-workers weren't always supportive. "People would try to drive a wedge between us," says Sharon. They'd say, 'Yesterday, Linda told me this.' And I would know she hadn't. Or people would say, 'Wow, you're so lucky.' And I would say, 'You do realize we only get half pay.' "

JOINED AT THE HIP

THE PAIR MOVED from compensation to recruiting at Mellon in 1995, a job that proved far more demanding on their time than they'd expected, with a boss who was less comfortable with the arrangement than they'd hoped. "We were told that if we wanted to be on the A-team, we needed to work full-time," says Sharon. "So we decided to look elsewh

It didn't take them long to find an compensation consultant job to share financial-services industry in Pittsbu relatively small: Sandy Short, a colle at Mellon who'd helped set up Sharo Linda's job share, had moved to PNC was hiring. But even Short needed convincing. PNC was in the midst of organization, and she wondered having to manage two people inste one. Sharon and Linda assured her they would manage each other. In after five years on the job, they mov another that was created for them soon eliminated in a restructuring.

Following a two-year turn at C Castle International Corp., which l cell tower space, they were rehired at



PLAYBOOK: BEST PRACTICES

VIDE TIME, T TASKS

to remind everybody, e even each other, that vision of time, not tasks. ust split the job in half.

4 STAY IN THE LOOP

Communicate, communicate, communicate—and then talk some more. No one should ever think that just because you are at home you don't know what's going on at the office.

5 SHARE CREDIT—AND BLAME

You can never assign sole credit or blame, and don't let anybody else do so, either. You're supposed to be one employee and, when the time comes, you'll get just one raise.

enee Rossi, a senior human resources ager who initially was unsure that people could share the position. on and Linda's work as compensa- consultants didn't require daily in- tion with colleagues outside their de- nent. The role of a human resources ralist would be different, and the fi- e managers who Sharon and Linda d be advising worried that the job e would complicate their lives. As i says: "They had to be reassured if they had a conversation about an oyee issue with Sharon on Tuesday they wouldn't have to start over with a on Wednesday." After extensive in- ews and reference checks, Rossi l tell the managers they wouldn't. then, Sharon and Linda were expert at one of the most important things anyone can do for their career: managing a boss's expectations. As Rossi recalls: "Sharon warned me, 'Remember that you didn't hire two people who are on call all the time.' And I did find myself excited that I had two people. I had to remind myself that they were really one person." Rossi also had to resist the tendency to divide assignments based on each one's strengths. Sharon is very organized, Linda less so. Sharon is a confident public speaker who likes leading group training sessions; Linda prefers one-on-one interactions.

A year and a half ago, Linda and Sharon's position was eliminated. They returned to dealing with compensation at PNC, their seventh job together. As is often the case with them, the move was lateral. As Linda says: "Would we be in the same place if we both worked full-time? No." But over the years they have rejected offers of full-time jobs. "There may be certain situations we don't like, but we're willing to do pretty much anything because we treasure working with each other," says Sharon.

This spring, Sharon began working at home on her days off on an independent project for PNC. Her department is short-staffed, and she is ready to work more now that her kids are older. But she's uneasy about the new situation. "I'm not used to it, and I don't really like it," she says. "Linda and I are not as connected."

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th your doctor first. Make sure you are healthy enough sex. If you have chest pain, nausea, or other discomforts sex, seek medical help right away.

gh erections lasting for more than four hours may occur ith all ED treatments in this drug class, to avoid long-term , it is important to seek immediate medical help.

instances, men taking PDE5 inhibitors (oral erectile ction medicines, including VIAGRA) reported a sudden se or loss of vision. It is not possible to determine r these events are related directly to these medicines her factors. If you experience sudden decrease or loss of vision, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

The most common side effects of VIAGRA are headache, facial flushing, and upset stomach. Less common are bluish or blurred vision, or being sensitive to light. These may occur for a brief time. Remember to protect yourself and your partner from sexually transmitted diseases.

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This medicine can help many men when it is used as prescribed by their doctors. However, VIAGRA is not for everyone. It is intended for use only by men who have a condition called erectile dysfunction. **VIAGRA must never be used by men who are taking medicines that contain nitrates ot any kind, at any time. This includes nitroglycerin. If you take VIAGRA with any nitrate medicine your blood pressure could suddenly drop to an unsate or life threatening level.**

• What Is VIAGRA?
VIAGRA is a pill used to treat erectile dysfunction (impotence) in men. It can help many men who have erectile dysfunction get and keep an erection when they become sexually excited (stimulated).

You will not get an erection just by taking this medicine. VIAGRA helps a man with erectile dysfunction get an erection only when he is sexually excited.

• How Sex Affects the Body
When a man is sexually excited, the penis rapidly fills with more blood than usual. The penis then expands and hardens. This is called an erection. After the man is done having sex, this extra blood flows out of the penis back into the body. The erection goes away. If an erection lasts for a long time (more than 6 hours), it can permanently damage your penis. You should call a doctor immediately if you ever have a prolonged erection that lasts more than 4 hours.

Some conditions and medicines interfere with this natural erection process. The penis cannot fill with enough blood. The man cannot have an erection. This is called erectile dysfunction if it becomes a frequent problem.

During sex, your heart works harder. Therefore sexual activity may not be advisable for people who have heart problems. Before you start any treatment for erectile dysfunction, ask your doctor if your heart is healthy enough to handle the extra strain of having sex. If you have chest pains, dizziness or nausea during sex, stop having sex and immediately tell your doctor you have had this problem.

• How VIAGRA Works
VIAGRA enables many men with erectile dysfunction to respond to sexual stimulation. When a man is sexually excited, VIAGRA helps the penis fill with enough blood to cause an erection. After sex is over, the erection goes away.

• VIAGRA Is Not for Everyone
As noted above (*How Sex Affects the Body*), ask your doctor if your heart is healthy enough for sexual activity.

If you take any medicines that contain nitrates – either regularly or as needed – you should never take VIAGRA. If you take VIAGRA with any nitrate medicine or recreational drug containing nitrates, your blood pressure could suddenly drop to an unsafe level. You could get dizzy, faint, or even have a heart attack or stroke. Nitrates are found in many prescription medicines that are used to treat angina (chest pain due to heart disease) such as:

- nitroglycerin (sprays, ointments, skin patches or pastes, and tablets that are swallowed or dissolved in the mouth)
- isosorbide mononitrate and isosorbide dinitrate (tablets that are swallowed, chewed, or dissolved in the mouth)

Nitrates are also found in recreational drugs such as amyl nitrate or nitrite ("poppers"). If you are not sure if any of your medicines contain nitrates, or if you do not understand what nitrates are, ask your doctor or pharmacist.

VIAGRA is only for patients with erectile dysfunction. VIAGRA is not for newborns, children, or women. Do not let anyone else take your VIAGRA. VIAGRA must be used only under a doctor's supervision.

• What VIAGRA Does Not Do
- VIAGRA does not cure erectile dysfunction. It is a treatment for erectile dysfunction.
- VIAGRA does not protect you or your partner from getting sexually transmitted diseases, including HIV — the virus that causes AIDS.
- VIAGRA is not a hormone or an aphrodisiac.

• What To Tell Your Doctor Before You Begin VIAGRA
Only your doctor can decide if VIAGRA is right for you. VIAGRA can cause mild, temporary lowering of your blood pressure. You will need to have a thorough medical exam to diagnose your erectile dysfunction and to find out if you can safely take VIAGRA alone or with your other medicines. Your doctor should determine if your heart is healthy enough to handle the extra strain of having sex.

Be sure to tell your doctor if you:

- have ever had any heart problems (e.g., angina, chest pain, heart failure, irregular heart beats, heart attack or narrowing of the aortic valve)
- have ever had a stroke
- have low or high blood pressure
- have ever had severe vision loss
- have a rare inherited eye disease called retinitis pigmentosa
- have ever had any kidney problems
- have ever had any liver problems
- have ever had any blood problems, including sickle cell anemia or leukemia
- are allergic to sildenafil or any of the other ingredients of VIAGRA tablets
- have a deformed penis, Peyronie's disease, or ever had an erection that lasted more than 4 hours
- have stomach ulcers or any types of bleeding problems
- are taking any other medicines

• VIAGRA and Other Medicines
Some medicines can change the way VIAGRA works. Tell your doctor about **any medicines** you are taking. Do not start or stop taking any medicines before checking with your doctor or pharmacist. This includes prescription and nonprescription medicines or remedies:

- Remember, VIAGRA should never be used with medicines that contain nitrates (see *VIAGRA Is Not for Everyone*).
- If you are taking alpha-blocker therapy for the treatment of high blood pressure or prostate problems, you should not take a dose of greater than 25 mg of VIAGRA at the same time (within 4 hours) as you take your dose of alpha-blocker.
- If you are taking a protease inhibitor, your dose may be adjusted (please see *Finding the Right Dose for You*).
- VIAGRA should not be used with any other medical treatments that cause erections. These treatments include pills, medicines that are injected or inserted into the penis, implants or vacuum pumps.

• Finding the Right Dose for You
VIAGRA comes in different doses (25 mg, 50 mg and 100 mg). If you do not get the results you expect, talk with your doctor. You and your doctor can determine the dose that works best for you.

- Do not take more VIAGRA than your doctor prescribes.
- If you think you need a larger dose of VIAGRA, check with your doctor.
- VIAGRA should not be taken more than once a day.

If you are older than age 65, or have serious liver or kidney problems, your doctor may start you at the lowest dose (25 mg) of VIAGRA. If you are taking protease inhibitors, such as for the treatment of HIV, your doctor may recommend a 25 mg dose and may limit you to a maximum single dose of 25 mg of VIAGRA in a 48 hour period. If you are taking alpha-blocker therapy, you should not take a dose of greater than 25 mg of VIAGRA at the same time (within 4 hours) as your dose of alpha-blocker.

• How To Take VIAGRA
Take VIAGRA about one hour before you plan to have sex. Beginning in about 30 minutes and for up to 4 hours, VIAGRA can help you get an erection if you are sexually excited. If you take VIAGRA after a high-fat meal (such as a cheeseburger and french fries), the medicine may take a little longer to start working. VIAGRA can help you get an erection when you are sexually excited. You will not get an erection just by taking the pill.

• Possible Side Effects
Like all medicines, VIAGRA can cause some side effects. These effects are usually mild to moderate and usually don't last longer than a few hours. Some of these side effects are more likely to occur with higher doses. The most common side effects of VIAGRA are headache, flushing ot the face, and upset stomach. Less common side effects that may occur are temporary changes in color vision (such as trouble telling the difference between blue and green objects or having a blue color tinge to them), eyes being more sensitive to light, or blurred vision.

In rare instances, men taking PDE5 inhibitors (oral erectile dysfunction medicines, including VIAGRA) reported a sudden decrease or loss of vision in one or both eyes. It is not possible to determine whether these events are related directly to these medicines, to other factors such as high blood pressure or diabetes, or to a combination of these. If you experience sudden decrease or loss of vision, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

In rare instances, men have reported an erection that lasts many hours. You should call a doctor immediately if you ever have an erection that lasts more than 4 hours. If not treated right away, permanent damage to your penis could occur (see *How Sex Affects the Body*).

Heart attack, stroke, irregular heart beats, and death have been reported rarely in men taking VIAGRA. Most, but not all, of these men had heart problems before taking this medicine. It is not possible to determine whether these events were directly related to VIAGRA.

VIAGRA may cause other side effects besides those listed on this sheet. If you want more information or develop any side effects or symptoms you are concerned about, call your doctor.

• Accidental Overdose
In case of accidental overdose, call your doctor right away.

• Storing VIAGRA
Keep VIAGRA out of the reach of children. Keep VIAGRA in its original container. Store at 25°C (77°F); excursions permitted to 15-30°C (59-86°F) [see USP Controlled Room Temperature].

• For More Information on VIAGRA
VIAGRA is a prescription medicine used to treat erectile dysfunction. Only your doctor can decide if it is right for you. This sheet is only a summary. If you have any questions or want more information about VIAGRA, talk with your doctor or pharmacist, visit www.viagra.com, or call 1-888-4VIAGRA.

Pfizer U.S. Pharmaceuticals

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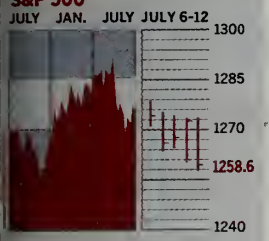
July 2005

ersonal Finance Figures of the Week

OCKS

S&P 500



MMENTARY

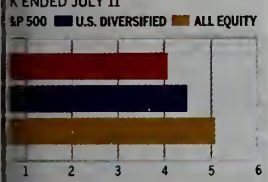
confluence of tech profit
ies and international
ions sent stocks sharply
r to end the week. The Dow
ged 122 points on July 12,
the tech-heavy NASDAQ
nearly 2% to close the
k down a lachrymose 3%.
ers sold on bad hardware
retail news, as well as new
ids of violence in Israel,
anon, and India.

Bloomberg Financial Markets, Reuters

UTUAL FUNDS

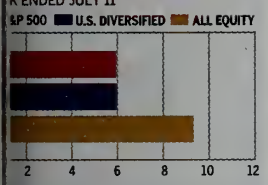
EEK TOTAL RETURN

K ENDED JULY 11



WEEK TOTAL RETURN

K ENDED JULY 11



Standard & Poor's

U.S. MARKETS

	JULY 12	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1258.6	-1.0	0.8	3.0
Dow Jones Industrials	11,013.2	-1.2	2.8	4.7
NASDAQ Composite	2090.2	-2.9	-5.2	-2.5
S&P MidCap 400	745.9	-1.7	1.1	5.1
S&P SmallCap 600	365.8	-2.2	4.3	5.0
DJ Wilshire 5000	12,648.8	-1.2	1.2	3.7

SECTORS

BusinessWeek 50*	708.5	-2.0	-4.5	-2.4
BW Info Tech 100**	365.8	-2.6	-3.8	0.3
S&P/Citigroup Growth	579.9	-1.1	-2.8	-0.8
S&P/Citigroup Value	677.3	-0.8	4.6	6.9
S&P Energy	430.8	0.8	15.6	19.4
S&P Financials	433.0	-0.6	1.6	7.2
S&P REIT	173.6	1.2	13.5	10.7
S&P Transportation	273.3	-3.5	9.4	30.4
S&P Utilities	165.7	0.7	3.8	1.2
GSTI Internet	165.2	-4.2	-19.5	-2.0
PSE Technology	759.9	-2.6	-9.2	-3.0

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	JULY 12	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1663.7	0.2	10.1	20.9
London (FT-SE 100)	5860.6	0.6	4.3	12.3
Paris (CAC 40)	4941.7	0.4	4.8	14.6
Frankfurt (DAX)	5637.8	0.2	4.2	21.2
Tokyo (NIKKEI 225)	15,249.3	-1.8	-5.4	30.4
Hong Kong (Hang Seng)	16,522.2	1.6	11.1	16.8
Toronto (S&P/TSX Composite)	11,771.1	1.2	4.4	15.3
Mexico City (IPC)	19,419.4	-0.5	9.1	39.0

FUNDAMENTALS

	JULY 11	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.86%	1.84%	2.00%
S&P 500 P/E Ratio (Trailing 12 mos.)	17.0	17.1	19.3
S&P 500 P/E Ratio (Next 12 mos.)*	13.9	14.0	15.4
First Call Earnings Surprise*	8.63%	8.90%	1.91%

*First Call Corp.

TECHNICAL INDICATORS

	JULY 11	WEEK AGO	READING
S&P 500 200-day average	1263.7	1262.6	Negative
Stocks above 200-day average	55.0%	59.0%	Neutral
Options: Put/call ratio	0.85	0.80	Positive
Insiders: Vickers NYSE Sell/buy ratio	2.48	2.73	Neutral

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Steel	15.1	Steel	113.3
Oil & Gas Exploration	14.3	Agricultural Products	104.5
Gold Mining	13.9	Divsfd. Metals & Mining	65.0
Oil & Gas Refining	12.3	Oil & Gas Equip.	57.9
Oil & Gas Equip.	11.6	Constr. & Engineering	52.3

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Instrumentation	-11.2	Homebuilding	-41.1
Comptr. Stge. & Perphs.	-10.6	Tires & Rubber	-36.9
Electric Mfg. Svcs.	-9.6	Educational Services	-32.9
Educational Services	-9.4	Home Entertainment	-29.8
Tires & Rubber	-8.5	Home Furnishings Rtlrs.	-26.9

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Latin America	23.5	Precious Metals	69.9
Precious Metals	18.8	Latin America	50.7
Natural Resources	13.8	Diversified Emrg. Mkts.	33.2
Diversified Emrg. Mkts.	12.9	Japan	31.2
LAGGARDS		LAGGARDS	
Technology	2.1	Technology	0.7
Domestic Hybrid	2.8	Health	2.4
Communications	3.2	Large-cap Growth	3.0
Health	3.5	Domestic Hybrid	4.7

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
DireXion L. Am. Bl. 2X Inv.	46.2	U.S. Global Invrs. Gold	104.9
ProFunds Prec. Mtls. Inv.	34.4	Midas	101.5
PFds. UltEmrg. Mkts. Inv.	34.1	U.S. Glbl. Invs. Prc. Mnls.	95.1
DireXn. Emrg. Mkts. Bl. 2X	29.8	ING Russia A	85.6
LAGGARDS		LAGGARDS	
PFds. USh. Emrg. Mkts. Inv.	-29.3	Ameritor Investment	-75.0
DireXion Emrg. Mkts. Sht.	-27.7	American Heritage Growth	-33.3
ProFds. Sh. Prec. Mtls. Inv	-19.1	ProFunds. Semicdr. Inv.	-22.9
ProFunds UltSh. Jap. Inv.	-18.2	American Heritage	-22.2

INTEREST RATES

KEY RATES

	JULY 12	WEEK AGO	YEAR AGO
Money Market Funds	4.74%	4.71%	2.77%
90-Day Treasury Bills	5.07	5.01	3.20
2-Year Treasury Notes	5.17	5.24	3.84
10-Year Treasury Notes	5.10	5.22	4.14
30-Year Treasury Bonds	5.14	5.27	4.39
30-Year Fixed Mortgage†	6.70	6.72	5.60

†BanxQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	4.19%	4.53%
Taxable Equivalent	5.99	6.47
Insured Revenue Bonds	4.26	4.64
Taxable Equivalent	6.09	6.63

THE WEEK AHEAD

ISTRIAL PRODUCTION
nday, July 17, 9:15 a.m. » June factory output is ast to have bounced back , after a 0.1% dip in May. 's the median forecast of omists surveyed by Action omics. The factory utilization probably climbed to 81.9%, 81.7% in May.

DUCER PRICE INDEX
sday, July 18, 8:30 a.m. » Producer prices most likely rose 0.3% in June, following a 0.2% gain in May. Excluding food and energy, wholesale prices probably increased 0.2% in June, after a 0.3% jump in May.

CONSUMER PRICE INDEX
Wednesday, July 19, 8:30 a.m. EDT » Consumer prices for goods and services probably grew 0.3% in June, after a 0.4% jump in May. Less food and energy, the index likely posted a 0.2% rise, after three straight gains of 0.3%.

RESIDENTIAL CONSTRUCTION
Wednesday, July 19, 8:30 a.m. EDT » Housing starts in June are expected to have slipped to an annual pace of 1.9 million. In Ma, starts stood at an yearly pace of 1.96 million.

LEADING INDICATORS *Thursday, July 20, 10 a.m. EDT* » The Conference Board's index of leading economic indicators most likely edged up by 0.1% in June, after dropping 0.6% in May.

The *BusinessWeek* production index slipped to 281.3 for the week ended July 1, and stood 13.2% above the year-ago level. Before calculation of the four-week moving average, the index improved to 282.3.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras

BY GENE G. MARCIAL

INSURER ALLSTATE HAS REDUCED ITS HURRICANE EXPOSURE.

FAITHFUL SHOPPERS KEEP COMING TO ABERCROMBIE & FITCH.

ONE BIG OWNER WANTS SOUTHERN UNION GAS TO GET COOKIN(

Allstate: The Skies Clear

INVESTORS USUALLY RUSH FOR shelter during hurricane season by bailing out of casualty insurers. But now some are braving impending storms by buying into Allstate (ALL), the largest publicly traded homeowner's, auto, and life insurer. Cathy Seifert of Standard & Poor's rates Allstate a "strong buy." Its fundamentals are improving while the price-earnings ratio is depressed at just over 8; comparable insurers have p-e's of up to 25. The stock beat the market last year, she notes, despite hurricane losses of $5.7 billion from Katrina, Rita, and Wilma. Harry Fong of Calyon Securities, who rates it a "buy," says such losses won't be repeated this year. Allstate has cut its exposure in coastal states and raised prices. In Florida, Allstate has just 400,000 policies in force, down from 1.2 million before Hurricane Andrew in 1992, with further cutbacks to come, says Fong. What's more, Allstate now has reinsurance covering stormy states like Florida. This isn't yet fully reflected in Allstate's price, which fell from 63 a year ago to 55.17 on July 12, says Fong, who has a 12-month target of 70. Allstate is a strong cash generator and bought back $450 million worth of stock in the first quarter as part of a $1 billion 2006 buyback plan. Fong sees earnings of $7 a share this year and $7.40 in 2007, vs. $2.37 in 2005. Gabriel Solomon of T. Rowe Price, which owns shares, says Allstate's profits are more sustainable than the market perceives.

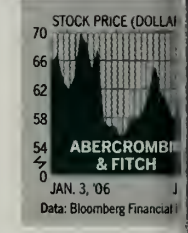
DOWN FROM A PEAK

Data: Bloomberg Financial Markets

At Abercrombie & Fitch, The Young and the Loyal

ABERCROMBIE & FITCH (ANF), known for its youth apparel, "is one of the best values in specialty retail," says Barbara Wyckoff of Buckingham Research Group. Buckingham, which owns shares, has a target for the stock, now at 54.41, of 75. That's based on 17 times Wyckoff's forecast of 2006 earnings of $4.40 a share and expected free cash flow of $2.54 a share. Next year she predicts profits will leap 20%, to $5.28 a share, based on increased volume. Wyckoff sees sales jumping to $3.3 billion in 2006 and to $3.8 billion in 2007, vs. 2005's $2.7 billion. "Affluent teens are unaffected by the slowing economy," she explains. And analysts note that the weak sales earlier in the year will provide better comparisons in the second half. Alexandra Hallen Utterman of investment bank William D. Witter, which owns shares, is also high on A&F. Its 20% operating margin, says Utterman, is among the best in its group. She likes the way A&F is appealing to a wider age group, from pre-teens to post-college kids. "The youth market is an ever-growing sector," she says, and A&F has introduced "new concepts (such as sophisticated casual wear for post-college) to broaden the demographic." Utterman notes tha A&F has kept its customers loyal by carefully providing different age groups with apparel tailored to them.

FOR NOW, A TAD CRUMPL

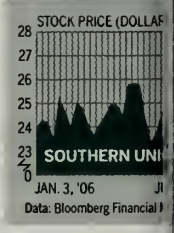


Data: Bloomberg Financial

A Sale in the Pipeline For Southern Union?

SOUTHERN UNION (SUG) FACES a battle with its lar shareholder, Sandell Asset Management, which own 9.2%. In a June 26 letter to Southern CEO George Lindemann, filed with the Securities & Exchange Commis Sandell CEO Thomas Sandell said the company should be because it is way undervalued. The stock jumped from 25 to 27 on the news and now trades at 26.56. The company stores and distributes natural gas. It owns 10,000 miles of pipeline that move gas from Texas, Oklahoma, and the Gulf of Mexico to the Great Lakes region. "Based on its under-valued assets and what may happen because of Sandell, we have a price target of 40," says Benjamin Segal of Winchester Capital Advisors, which owns shares. He says Lindemann, who controls 16% of the stock, should address the low valuatio trails its peers and trades below its intrinsic value of at lea 35, says Segal. Sandell says that, in the meantime, Southe should put its pipelines in a master limited partnership th doesn't pay tax. Calls to Southern Union were not returne

A SUDDEN LIFT



Data: Bloomberg Financial

BusinessWeek online Gene Marcial's Inside Wall Street is poste businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor t firms hold positions in the stocks under discussion. Similarly, they have no invest banking or other financial relationships with them.

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It's about money.
Earning it.
Investing it.
Spending it.

Check out this weekend's "Annual Retirement Guide" show July 15 and 16:

Psyched for Retirement?: Resources to help you prepare for the life you want and how to get there.

Counting Down: Tips to reach your financial goals no matter how far away retirement is.

Keep Your Options Open: Why annuities, target funds, and inflation-protected securities are becoming more tempting.

Not-So-Senior Discounts: Deals for those over 50, including travel and hotels, car insurance, and movie tickets.

BusinessWeek weekend

Airs Saturday/Sunday nationwide.
Find your local station
and air time
at www.businessweekweekend.com

Company Index

This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

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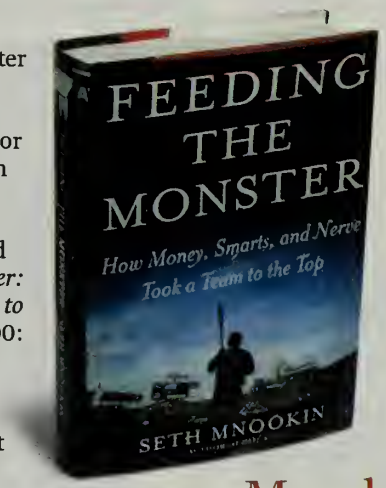
ulling Up the Red Sox

NG THE MONSTER How Money, Smarts, and Nerve Took a Team to the Top
th Mnookin; Simon & Schuster; 433pp; $26

: front office was in turmoil. Just a son removed from its first World ies triumph in 86 years, the Boston l Sox saw its dashing, thirtysome- ıg general manager, Theo Epstein, gn with little explanation. As a tracted and unusually public spat tinued between Epstein and Larry

nino, the team's demanding CEO, Sox were both enthralled and aghast. hat was really going on? Well, who better l us than a veteran reporter invited to around by the Red Sox lead investor elf? Seth Mnookin, a contributing editor *nity Fair*, cut just such a deal with John y, a billionaire commodities trader d sports tycoon. Mnookin got largely tered access, as well as a desk at fabled ay Park. The result, *Feeding the Monster: Money, Smarts, and Nerve Took a Team to op*, closely tracks Sox history since 2000: ıess triumphs, blockbuster trades, the ely path to the 2004 World Series ry, and the dramas of 2005. It's a ling and largely flattering account that ld engage even readers with little hment to Red Sox Nation.



ere can be no doubt that the Red Sox owners have ered the goods. For generations, the franchise had been tar-crossed darlings of New England, charismatic if ess underachievers who could be depended on to implode ı the going got tough. On the business side, performance even worse. Past owners had allowed the 94-year-old ay to go to seed. There was little in the way of creative eting, and relations with the Boston media were a joke. ter Henry, a pale, unathletic-looking man with a love of s and a facility for numbers (as a teen in rural Arkansas, idly followed the St. Louis Cardinals on the radio and lated batting averages in his head). He had been a serial tor in Major League Baseball franchises, starting in the s with a 1% share of the New York Yankees. By 2001 he controlling owner of the Florida Marlins and losing a long e with state officials to win a taxpayer-financed stadium. enry sold the Marlins to Jeffrey Loria, owner of the then- treal Expos, allowing him to accept an invitation from hino and TV producer Tom Werner to become the money in their expensive pursuit of the Red Sox. The appro- tely $700 million sale of the Sox closed in January, 2002, ıot before the trio had to trounce rival groups and win over skeptics in the rush-to-judgment Boston media.

Of course, the Red Sox sale was front-page news, and readers may recall at least some of the particulars. But Mnookin's insider status yields new details, including a last-minute demand by the sellers to keep their season tickets and luxury suites at Fenway Park. The attempted power play irked Henry, who wanted the prime seats for his partners. He had the last laugh: The Red Sox simply installed two rows of new, even better seats right in front of those of the old owners.

Feeding the Monster (a reference to Fenway's "Green Monster," the iconic 37-foot left field wall) delves deeply into the financial challenges faced by Henry & Co. They are forever under pressure to buy star players with salaries that can climb to $15 million a year in order to keep pace with the Yankees, their well-financed Bronx nemesis. This quest for dollars and fan loyalty drives the Red Sox owners even in the best of times. In four years since buying the team, Henry and partners have spent $100 million in Fenway improvements, including the addition of revenue-generating seats atop the Green Monster and right-field roof. But they have a seller's market: As of July 7 the Red Sox had sold out 263 straight regular-season home games, the second-longest streak in major league history.

Mnookin buys management's rhetoric that increased revenue-sharing, Commissioner Bud Selig's pet project, unfairly bleeds successful clubs. "In 2004, a year in which the Red Sox raised ticket prices, set attendance records, sold more merchandise than any year in their history, and won the World Series, the team lost money," the author says. But it's hard to feel bad for the hugely wealthy Henry. If ownership is such a lousy proposition, why not sell out? Mnookin may feel a bit too indebted to Henry, who at times comes across as almost saintly. When Henry goofs—as he did in allowing the Epstein incident to spin out of control—Mnookin is slow to point a finger.

Mnookin was granted a skybox view of the team's resurrection

So what's the real story behind the Lucchino-Epstein tiff? The author writes that Lucchino expects unswerving loyalty and didn't feel the love coming from Epstein. For his part, the young GM, who returned to his job prior to the 2006 season, craved acknowledgment that he was more than a callow kid. In short, it's not that different from office politics everywhere. Only with the Red Sox, all of America is watching. ■

–By Mark Hyman

IdeasFaceTime
WITH MARIA BARTIROMO

Bob Nardelli Explains Himse

HOME DEPOT'S hard-charging, lavishly paid chairman and CEO, Bob Nardelli, has been on the firing line lately because of his decision to, in effect, treat shareholders at May's annual meeting as a nuisance even as the stock price remains depressed. At the same time, the queue of Depot customers with complaints about service has been stretching out into the parking lot. On my CNBC show last week and again in the extensive interview below, Nardelli acknowledged missteps and, to his credit, made clear that the buck stops at his desk.

NARDELLI "Nobody is more aligned with shareholders than me"

Why did you ask your board not to attend the annual meeting? People who were there said the meeting was bullying, clocks were timing questions, you didn't answer questions about your pay and the stock performance. What were you thinking to conduct such a meeting?

I tried a new format; it didn't work. I take full responsibility for it, and within seven days [after the meeting], I said I was committed to going back to the other format. Directors will be [at the next meeting]...we will do a business review.

People feel as though you are closed to shareholders and analysts. In addition to the botched shareholders' meeting, you changed the metrics on which you are gauged in the middle of the game. You signed on to the idea that your performance would be gauged relative to the stock price. That didn't go well, so you changed it so that your performance is tied with the performance of earnings. Why is this acceptable?

It's not exactly correct that I signed on relative to the stock price. So I'm not sure where that notion comes from.... A few years ago, we introduced the long-term incentive program for senior managers in the company. It was the first time that we put in place a long-term incentive plan. It was tied to a retail index—and I am happy to share who was in the index—but basically you would see variations of: down 30% one year, up 20% the next, then down 30%. These were retailers that were totally different Home Depot]...companies like Amazon and Dollar Genera and the board felt, that we should measure our leadershi as it relates to those things over which we have direct contr earnings per share. And with full board approval...it was that we would modify the measurement to earnings per and that is what we have done going forward.

[Home Depot's] financial performance has done well unde leadership, though shareholders yet to benefit. The stock is down since you took over.

I am very proud of what the tea accomplished. Sales have gone $45 billion to $81 billion. Earnir share have gone from $1.10 to $ 147% increase in five years. Ou ating margin has grown by 25(points. Return on invested capita 28 basis points, from $19. $22.40. We have returned $15 to shareholders in the form o dends and opened 900 stores.

But some people want you to ta pay cut. How do you justify a $2 million pay package with share down 30%?

First of all, let me say that of the million reported, over 80% of that is tied directly to equity still held by the company, and of the 80% of equity, 60% is ed to stock options. So if the stock doesn't go up, there is n payout to me. Therefore, I really feel no one is more aligne shareholders than me, and no one has more of a vested i in wanting the stock to reach the intrinsic value that it s Clearly, that value is not reflected in today's stock price.

Why do you think that is?

We are going through a transformational period as we re the business, building off of our core, adding services for ing population that has shifted from do-it-yourself to do me and that has shifted to shopping online. Certainly, bu off of the 30% of professional customers, extending prod ferings [to them] is one of the most defining moments history. We will look back on this as a turning point i tioning the company for the next leg of expansion.

What about your decision to stop reporting comparable st sales—a key industry benchmark? How are shareholders

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supposed to keep track of your business if they can't get a read on same-store sales every month? Will you reverse this decision?
We made one of the boldest decisions in the history of the company to go to segment reporting, where we break out the wholesale business from the retail business. By doing so...we significantly increased the level of transparency to our shareholders. But right after the shareholder meeting...I spent five days meeting with 500 to 600 associates across the country. The following week I talked with analysts and investors about the annual meeting and the comparable sales. We committed to revisiting the decision [on same store sales]. If we reverse it, we will do so at the second-quarter meeting [in August]. We are giving it serious consideration.

Is it fair to say the decisions you have made in the past six months lead people to question other decisions that you make pertaining to the direction of the company?
I certainly hope not. The decision on the shareholder meeting was my decision, and I take full responsibility for that. But it would be unfortunate if this one event would negatively impact five years of what I would classify as very solid financial performance.

Talk to me about strategy. Critics say you bought your way into the supply business by overpaying for companies like Hughes Supply, among others. Why is this part of the business important, and how can you win support for this strategy?
Clearly we did not overpay for Hughes or any of the 40 acquisitions that we have done during the last four years. Hughes is a glove fit. This is a defining moment that has allowed us to build off the 30% of our revenue [coming from professionals].

The customer-friendly culture that was once a hallmark of Home Depot seems to have deteriorated on your watch. Has cutting costs at the expense of customer service backfired?
I think when you are in retail, you wake up every morning focused on customer service. We are blessed to be No. 1 in home improvement. We can never rest on our laurels. We recognize that every day you have to improve in every aspect of retail. We have demonstrated that by taking our average ticket from $38 to $60. We are responding to the customer. We are continuing with self-checkout to reduce lines on the floor. We will spend $600 million this year on training for hourly associates. We have added signage, points of purchase. The stores are brighter, cleaner, and more navigable.

So why has Lowe's outperformed Home Depot by such a margin during the longest bull market in housing we have ever seen?

"We are responding to the customer," Nardelli maintains

I think Lowe's is certainly a competitor. We have develo strategy [based on the fact] t are further along on the ma curve. We have done a great redefining ourselves, being se to the markets and customer if we stay on strategy, tha manifest itself in the stock pr

How big an impact will the hou slowdown have on your botto
We prepared in Novembe downward pressure in the housing market. We built in a 10%...market fluctuation.

So no impact on earnings?
That is right.

Tom Taylor, executive VP for merchandising and marketing a 23-year veteran, resigned on July 7—the second marketi EVP to depart in the last year. He was considered Home De only remaining retail expert, and Wall Street sees his depa as a serious blow. A report by Credit Suisse First Boston a Gary Balter on July 10 questions whether Home Depot has retail expertise left in the top ranks. What happened?
This is totally Tom's decision, and to help us with an o transition, he has agreed to stay on as a consultant. If yo at our merchants who are in place under Tom, they have tal hundreds of years of experience...so we are blessed a steeped in merchandising experience.

You spent much of your career at General Electric and help build GE Power Systems into a $20 billion business. How w Jack Welch critique your performance as CEO of Home De
That's a good question. You probably ought to ask J wouldn't want to put words in his mouth. He can do th himself.

Maria Bartiromo is the host of CNBC's Closing Bell.

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Ideas The Welch Way

BY JACK AND SUZY WELCH

The Smarter They Are...

I am looking for advice about a situation you've probably had to deal with: a superior employee. You can't fire yourself, so what's the solution? Do you keep a lid on the employee's performance? Or hope the organization doesn't figure out your underling is better than you are?

—Richard Ginnaty, Orange, Calif.

Or how about this? You celebrate.

Look, the best thing that can happen to you as a boss—and you're right, it has happened to both of us—is hiring a person who is smarter, more creative, or in some way more talented than you are. It's like winning the lottery. Suddenly you've got a team member whose talent will very likely improve everyone's performance and reputation. Including yours.

Yes, it's human nature to feel as you do—fearful that a "superior" employee could make you look, well, inferior, and perhaps slow down your career progress. But in reality, the exact opposite usually occurs.

The reason is that leaders are generally not judged on their personal output. What would be the point of evaluating them like individual contributors? Rather, most leaders are judged on how well they've hired, coached, and motivated their people, individually and collectively—all of which shows up in the results. That's why when you sign up top performers and release their energy, you don't look bad. You look like the goose that laid the golden egg.

...the more you look like a genius. Why you shouldn't fear that whiz you hired

So keep laying them. It is a rare company that doesn't love a boss who finds great people and creates an environment where they flourish. And you don't have to be the smartest person in the room to do that. Indeed, when you consistently demonstrate that leadership skill and come to be known as the person in your company who can land and build the best, watch your career take off.

Now, we're not saying managing "superior" employees on your team is necessarily easy. Your question, in fact, reminds us of one we received in Chicago several years ago from an audience member who said two of his seven direct reports were smarter than he was. He asked: "How can I possibly appraise them?"

"What the heck happened to the other five?" was our attempt at a lighthearted response. But we took his point. How in the world do you evaluate people whom you feel more talented than you?

You don't. That is, you don't evaluate them on their intelligence or particular skill set. Of course, you talk abo what they are doing well, but just as important, you focu areas in which they can improve. It is no secret that som smart people have trouble, for instance, relating to colle or being open to other people's ideas. Indeed, some stru with becoming leaders themselves. And that is where yo experience, self-confidence, and coaching come into play

In that way, then, managing superior employees is jus managing regular types. You have everything to gain fro celebrating their growth and nothing at all to fear.

After 61 years as a family business, our company was just s to a $250 million corporation. We'll operate independently everyone will keep their jobs. Everything is the same, but it How do I, as president, and my employees make the quicke adjustment to our new world?

—Bing J. Carbone, Bridgeport,

Congratulations, and congratulations. The first for the d itself since you and your top team probably did pretty w cashing out. And you should feel great about the financi rewards of building a company that the market loved.

The second congratulations is for realizing that, even though everything might look the same going forward, nothing will be. You've been acquired. You and your peo now work for someone else. And even if that someone el likes you very much, they will have their own way of doi things. HR will have a new way of appraising people. Fi will have a new way of formatting the numbers. There w new processes, policies, and procedures galore.

And so the quickest and most appropriate way for you adjust is to buy in. You don't have to stifle yourself. But y energy about change should be positive and any criticis constructive. No moaning about how "we used to..." or groaning about how "it was better in the old days." Very bluntly, you gave that right away with the cash-out.

Being acquired is one of the most traumatic upheaval company can live through. For you, money may have tak away the sting. But if you want your people and organiz to thrive—and clearly, you do—then your message must simple: The past is over. Get on with the new. ■

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at **thewelchway@businessweek.com.** *For their weekl podcast, go to www.businessweek.com/search/podcasting.htm*

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The New Multinationals

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BY PETE ENGARDIO (P.40)

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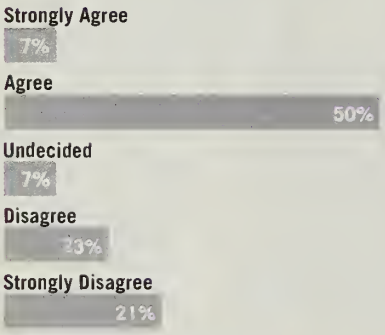

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High-Tech Toys for Tots

Hasbro's I-Ca speaker for di music player

Gone are the days when a toy company could come up with a simple idea—say Barbie or Mr. Potato Head—and coast for decades. As kids opt for MP3s, computer games, and other **consumer electronics** at an ever-younger age, toy companies are under greater pressure to give their wares a high-tech face-lift. BusinessWeek.com's Special Report on Tech Toys explains why, in the months ahead, you' see more **children's gadgets** that light up, play music, and conn to each other and the Web—and presents some of the best of them in a slide show. Spend a day with some of the toughest testers around, thr year-olds, at **the fro lines of the high-tech business,** Fisher-Pri headquarters outsi Buffalo. Visit Whyville, a virtual world for 8- to 15- year-olds, and see how Internet communities are striving to educate youngsters and keep them safe from cyberpredators. And read what Mat veteran designer Gary Swisher has to say about **the challenges designing toys** for tech-savvy kids. Check out these features an more at: **www.businessweek.com/go/06toys**

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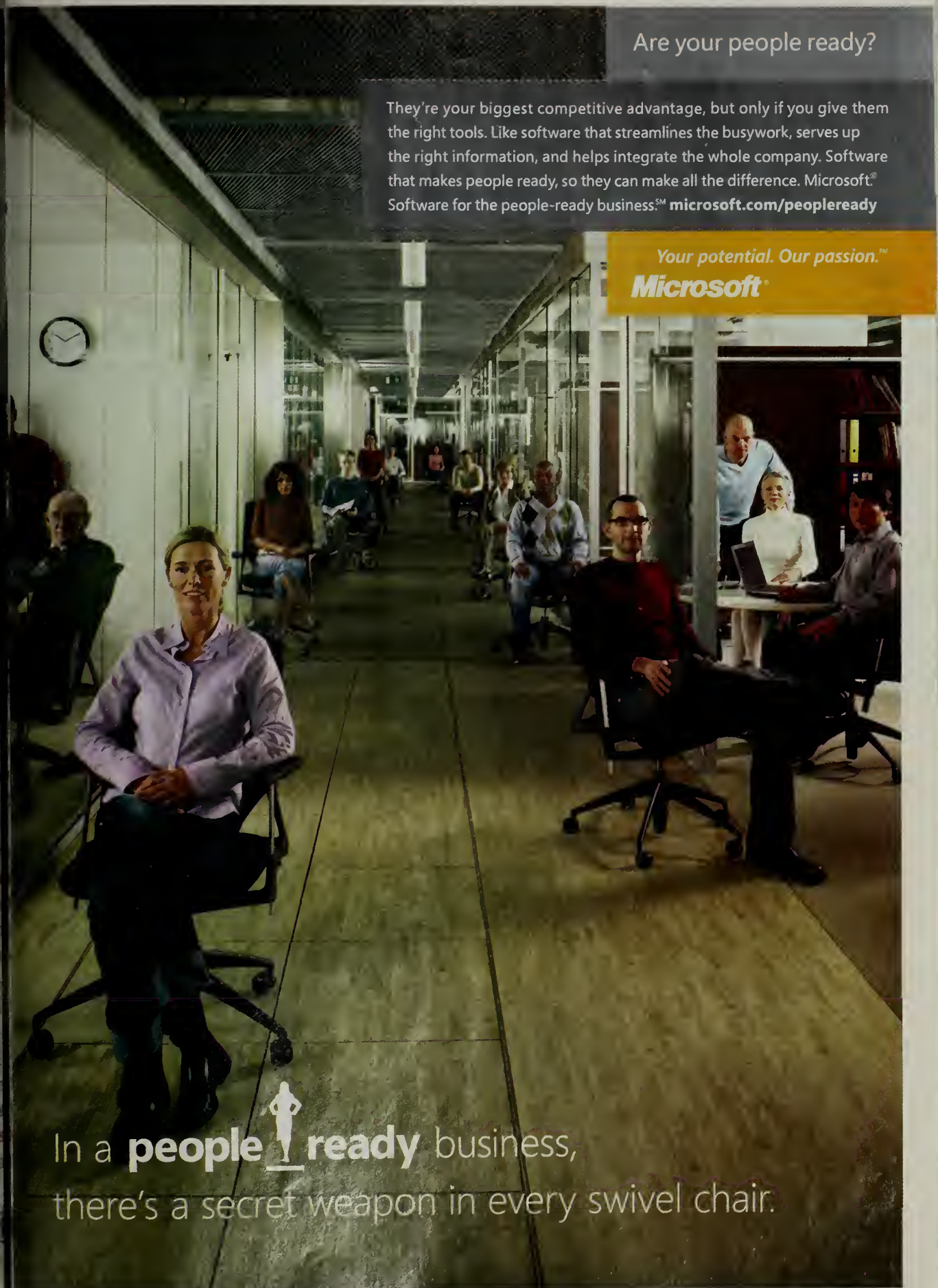

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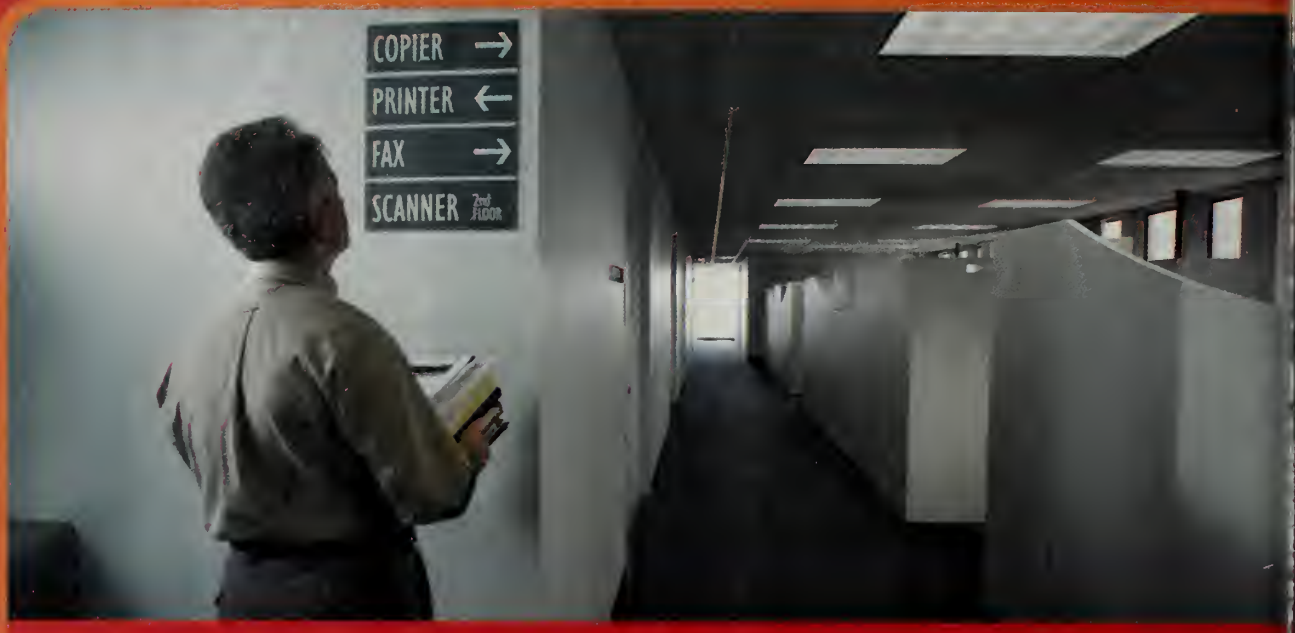

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UP Front

"I'm patient, but enough is enough."

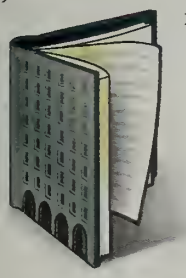
–Prince Alwaleed bin Talal, Citigroup's largest shareholder, recommending that investors sell their stock if the company doesn't rein in costs

ED BY DEBORAH STEAD

LITICAL CASH

MPANIES E SHOWING EIR HANDS

TAL MILLS has become test company to agree close its political ions—and the sixth this It joins **Amgen, Bristol-Squibb, Staples, ern Co.,** and **nald's** in ng to holders' nds for more parency s area, ially in state ocal politics. ch investor itions are gaining entum. Some 21% of holders supported them ast proxy season, up 11% last year, according **Center for Political ntability.** Last year five hips agreed to the sures, up from one (**Morgan Stanley**) in 2004, when the resolutions started surfacing.



The disclosures, typically posted on company Web sites, can make for compelling reading. (Corporate gifts to PACs are already made public in **Federal Election Commission** filings.) While Morgan made no political donations in 2005, **Johnson & Johnson** made quite a few, including $9.8 million to PhRMA California Initiative Fund, an industry group opposing a state proposition to create a drug discount for low-income families. The proposition failed.

"Political spending has consequences," says the center's co-director, Bruce Freed. In a post-Abramoff, post-SarbOx world, he adds, "investors are sending a message that they want accountability."

–Nanette Byrnes

RBATIM

EAN COUNTERS AT THE GATE

om "A message to American citizens in Lebanon," on uation plans, posted on the Web site of the U.S. Embassy eirut, July 15:

he Department of State reminds American citizens that the government does not provide no-cost transportation.... For the ion of your trip directly handled by the U.S. Government we will you to sign a promissory note and we will bill you at a later date.

om the State Dept.'s Web site, July 18, following criticism e reimbursement policy by congressional Democrats:

this extraordinary case, Secretary Rice has directed the e Department to waive the requirement for American citizens arting Lebanon to reimburse the United States Government heir travel costs.

LAST BLAST

From Steel To Slot Machines

SO IT HAS COME TO THIS. The once mighty **Bethlehem Steel** plant (above) in Bethlehem, Pa., whose furnaces forged girders for the Empire State Building and cannons for U.S. battleships, may have a future as a casino-hotel complex, complete with retail outlets. The $900 million project is being proposed by casino owner **Las Vegas Sands** and **BethWorks Now**, an investor group that bought the 126-acre site for $4 million in 2004.

The investors have been hosting tours of the shuttered factory. And a $200,000 model of the planned development sits at City Hall. Still, the project faces some opposition from local residents worried about traffic. To win support, the partners have cast themselves as preservationists, vowing to maintain many of the plant's buildings. The elevated rail system that once carried iron ore will become a people mover. The No. 2 machine shop? It will house a shopping mall. And by donating space, the developers may jump-start the long-delayed **National Museum of Industrial History**, to be created with the **Smithsonian Institution** on the site. "These are America's ruins," says Barry Gosin, a New York developer who is a lead investor. The furnaces near the mall, he promises, will be dramatically illuminated. *–Christopher Palmeri*

UpFront

RING TUNES

WILL APPLE ANSWER SONY'S CALL?

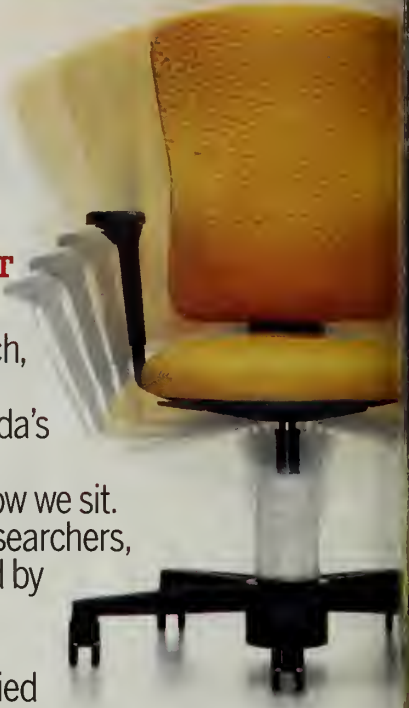
SONY'S WALKMAN brand mobile phone may be giving the iPod a run for its money, especially in cell-phone addicted Europe. Handsets carrying the Walkman name and equipped with built-in digital music players helped raise Sony Ericsson's second-quarter phone sales by 33%, to 15.7 million units. Apple's doing just fine; iPod sales grew 32%, to 8.1 million units. But for the first time, "music-optimized" phones like, Nokia's N91 and the Walkman phones that can hold thousands of songs, are gaining traction.

Sony Ericsson doesn't expect its Walkman to stomp the iPod. "I see it as opening up a new segment of the market rather than toppling iPod," says Steve Walker, product marketing VP at Sony Ericsson in London. And analysts see continuing growth for both types of devices.

The new music-capable phones offer features not found on iPods, such as the ability to record a tune sample, then find the song on the Web for downloading. Meanwhile, Apple CFO Peter Oppenheimer all but confirmed talk of Apple's entry into the phone market in a July 19 call with analysts. "We don't think the phones that are available today make the best music players. But over time that may change—and we're not sitting around doing nothing."

–Jack Ewing and Peter Burrows

TAKE A SEAT



Women perch and men slouch, according to a study by Canada's University of Waterloo on how we sit. Kinesiology researchers, commissioned by Toronto chairmaker Keilhauer, studied 16 students as they worked at PCs for 45-minute sessions. Women sat near the front edge, backs arched. Men slumped against the backrests. Keilhauer says its new chair, the Sguig (above), developed with Vienna design firm EOOS, has a backrest that can accommodate both postures to help prevent problems (upper back pain for women, lower back pain for men). For the restless, the chair also bounces up and down (like an exercise ball) and pivots side to side.

–Aili McCor

BLOGSPOTTING

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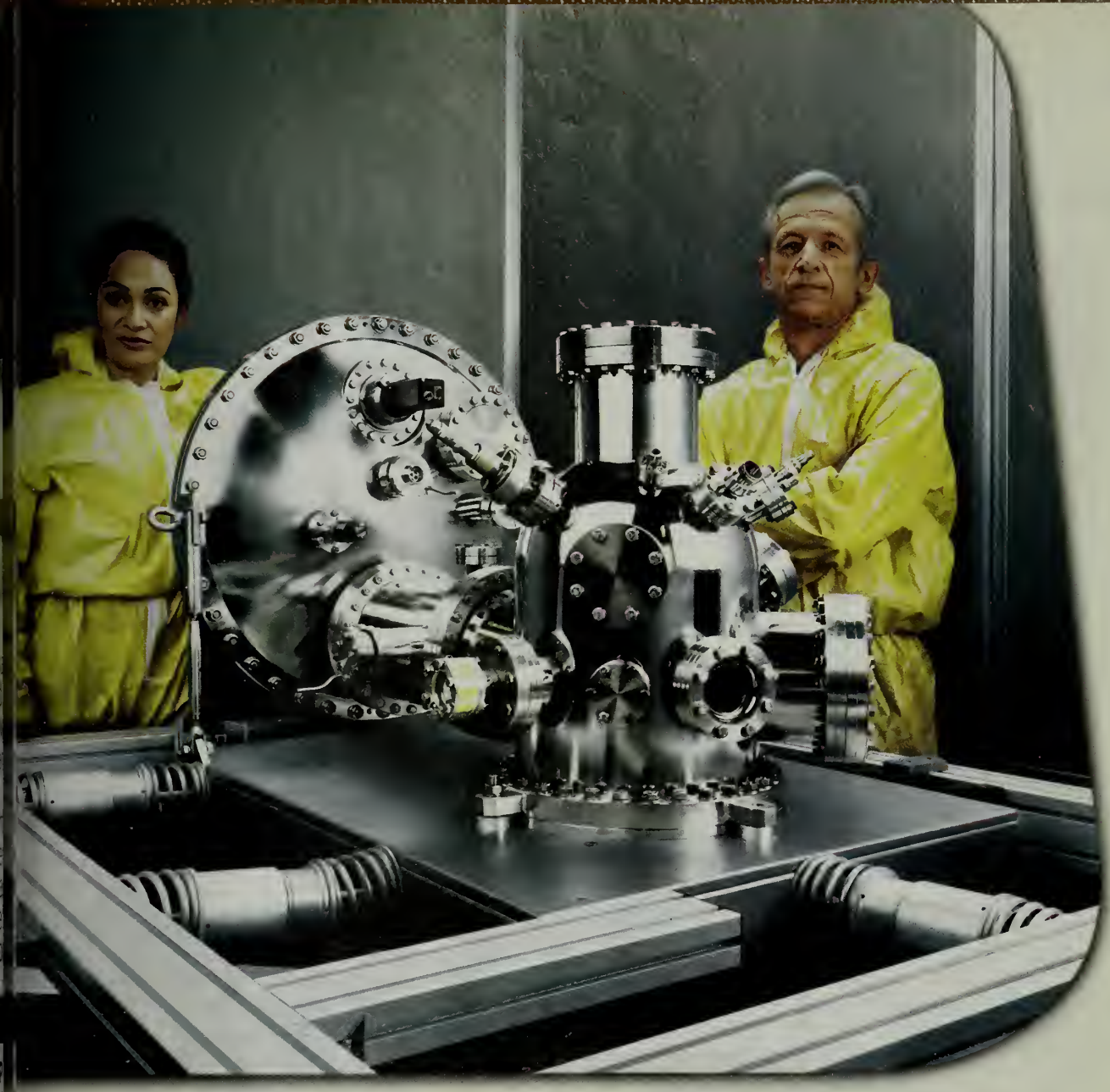
» **WHY READ IT** If you weren't among the glitterati at TED, the invitation-only Technology, Entertainment & Design confab that each winter collects some of the world's leading thinkers in these fields, you can catch up on the event's blog, which just added podcasts of speeches from the gathering. Some of the blog posts point readers to cutting-edge ad ideas and new books by design and tech luminaries such as information display artist Edward Tufte, whom *The New York Times* called "the Leonardo da Vinci of data."

–Jena McGregor

DRAWN & QUARTERED



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UPFront

NUKE NEWS

URANIUM PRICES GO NUCLEAR

Oil isn't the only fuel setting price records these days. Prices for uranium, the source for nuclear power, are up, too. Way up: They've jumped to a high of more than $45 a pound on the spot market, from $10 in 2003.

Such prices may be here to stay, as demand outpaces production. Some 27 reactors are under construction in Asia and Europe (with 38 more planned), as those regions seek alternatives to coal-fired generators. No one is building nukes in the U.S., but even here uranium demand is rising, thanks to capacity-expanding plant upgrades. For now, big atomic energy operators such as Chicago-based Exelon, which uses 8.5 million pounds of uranium annually, are largely insulated from the price spikes because they locked in supplies under long-term agreements years ago. But Merrill Lynch forecasts that as such contracts expire, uranium's fixed price will rise to $29.55 a pound next year, and to $45 in 2010, from $8.70 in 2001. As utilities seek rate hikes to cover rising coal and gas prices, high-priced uranium will add fuel to the fire. *–Michael Arndt*

IN THE CARDS

THANKS FOR THE RALLY, KIDS

BASEBALL CARDS have been in a sales slump for years. But there are signs that the losing streak could be snapping. While industrywide figures aren't available, Topps, which had about 40% of the sports-card market last year, recently announced that its card sales rose 27% in the quarter ended May 27. And now some retailers are reporting shortages. "We haven't been able to get cards in over a month," gripes a shop owner just outside New York City.

To revitalize the hobby among kids, the Major League Players Assn. and the cardmakers recently launched a $9 million TV and print ad campaign. At the same time, Major League Baseball and the Players Assn. tightened supplies by granting licenses to only two cardmakers this year instead of four. The idea, they say, is to make card collecting less confusing by eliminating some of the esoteric series that appeal mainly to collectors. "We wanted to start marketing cards to kids again," says Evan Kaplan, category director of trading cards and collectibles at the Players Assn. This year Topps and its only remaining rival, privately held Upper Deck, are producing a total of 40 lines of cards, compared the 90 sold by all makers year. All this may not be enough to get kids tradi players again. And it ma help Topps fend off a pai hedge funds that want t company to "enhance st holder value" by putting part of itself up for sale. shortages aren't a bad w generate buzz.

–Anne Te

FOODSTUFF

OUT, DAMNED TRANS FATS!

HOW DO YOU want those fries fried? Under fire for cooking with trans fats (linked to heart disease and obesity), some big restaurant chains—including Chili's Grill & Bar, Ruby Tuesday, and Panera Bread—are dropping the offending fats. The latest to do so: Wendy's International, which in August will start using a corn- and soybean-oil blend at its 6,400 U.S. and Canadian outlets. The switch will eliminate trans fats from its fried chicken and cut trans fat levels in a serving of fries to 0.5 grams.

Finding a substitute has been tough. Trans-fatty shortenings are stable, so they can be used in high-temp fryers for days. Wendy's began its oil hunt in 2004, testing six formulas and then secretly trying out two of them at hundreds of outlets before finding a winner. The blend is a bit tricky to use, says Lori Estrada, Wendy's senior president for R&D. (It m be filtered on schedule.) customers can't detect t substitution.

Taste is the big issue. years ago, McDonald's s would halve the trans fat its fried food within five months and eliminate th soon after. But its vats st bubble with the same oil Alternatives, says James Skinner, who became CE 2004, altered the taste o and Chicken McNuggets Yum! Brands, too, has ye find the right oil substitu its KFC chicken or Taco fare. But if Wendy's scor with consumers, the hea be on its rivals to try har

–Michael

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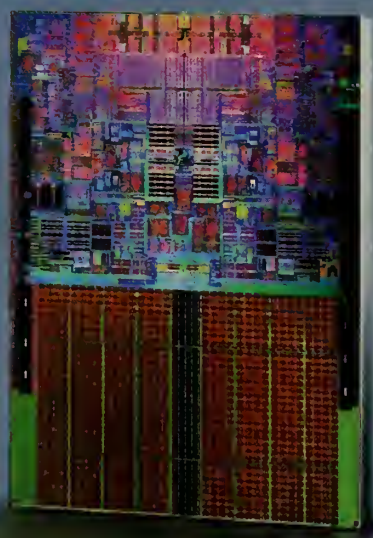

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> "Perhaps this article will… make it acceptable…for all companies to openly acknowledge and learn from their failures."
>
> *–Grace Dunklee Cohen*
> *Henniker, N.H.*

SPREAD THE WORD: EMBRACE YOUR MISTAKES

"HOW FAILURE BREEDS success" (Cover Story, July 10) should be a must-read for every executive and business student. Interestingly, the underlying theme throughout is to take time for thorough research and work closely with the intended end users from the beginning to ensure that your new product or service provides true value to your intended market. Thanks to these top executives for sharing their failure experiences and explaining how openly facing these failures ultimately made their organizations stronger. Perhaps this article will serve as a catalyst to make it acceptable business practice for all companies to openly acknowledge and learn from their failures.

–Grace Dunklee Cohen
Principal, Anthorne Group PR
Henniker, N.H.

THE STATEMENT BY Jeffrey R. Immelt, "you're never allowed in GE to make the same mistake twice," sounds impressive. But my wife and her friends in our community are baffled as to why there are multiple mistakes with their builder-equipped General Electric Co. kitchen appliances. They opted for upgrades, th ing they would not be plagued with end, high-maintenance units. Unfo nately, this logic was flawed.

After a year, GE service trucks making daily calls to change the netrons on our Spacemaker microw Range and dishwasher problems a to the service techs' workload. We chased an extended warranty whe had to replace the complete door as bly on our Profile Performance dishw er (electronic control failure). A yea we replaced the motor/pump/sole assembly (leaky pump). Yet this wee replacement pump does not comp empty the wash water. Here we go a

Lesson learned. Like Immelt, we not make the same mistake twice.

–David Cl
Warrington

TARGET SAYS ITS STRATEGY IS SPOT ON

"WHERE TARGET may miss the n (News: Analysis & Commentary, Ju continues a string of work by R Berner that has been blatantly inacc and grossly misleading. In powerfu trast to the unfounded claims ma

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ReadersReport

Mr. Berner, our credit-card strategy is carefully conceived and well-executed, and it provides Target Corp. with a compelling tool to foster stronger, deeper, and longer-lasting relationships with our best guests. In addition, it has produced consistent, industry-leading financial results over many years, and it continues to generate substantial incremental sales and profits in our core retail business.

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–Doug Scovanner
Executive Vice-President and CFO
Target Corp.
Minneapolis

ADVICE FROM A DISAPPOINTED GOOGLER

KUDOS TO BEN ELGIN for pointing out that Google, aside from search and maps, is a one-trick pony ("So much fanfare, so few hits," News: Analysis & Commentary, July 10). I was excited when Google Inc. announced its "page creator" earlier this year, thinking it would allow me to easily create Web pages. What a disappointment. It was robust—for 1997. It was difficult to navigate, with very little functionality. I gave up on it after a few minutes. One wonders if there is any oversight or review by grownups prior to launching these services. Google should spend more of its resources combating click fraud and less on useless, copycat offerings.

–David Michael
Lincoln, Calif.

BOUGHT-AND-PAID-FOR 'NEWS' IS NOTHING NEW

JON FINE'S "POLLUTING the blogosphere" (Media Centric, July 10) brought back memories of my years in Japan as a journalist during the 1950s and '60s. I discovered that paid-for stories and editorials had been an integral part of Western-style Japanese newspapers since their start in the late 1800s. These stories were often referred to as *chochin kiji*, or "lantern articles," meaning that they shed light on the topics concerned. The custom is still alive and well, but it is now more cleverly disguised.

–Boye Lafayette De Mente
Paradise Valley, Ariz.

HEDGE FUND HEIRS IS MORE LIKE IT

"HEDGE FUND TODDLERS" (News: Analysis & Commentary, July 3) gives the impression that no prior hedge fund experience is necessary to start a fund and that launching one is "easy" because all it requires is filing some "paperwork." At first, I was impressed by Rebellion Research Technologies because it seemed they had started from the ground up, with no experience.

I became less impressed as I read that Alexander C.E. Fleiss's mother manages her own hedge fund, and Spencer G. Greenberg's father manages another. What's more, Fleiss started the hedge fund with money he inherited from his grandfather. What person would not attempt to capitalize on these facts (i.e., pedigree)? Their "start" is no different than that of Donald Trump. Let's face it, Trump would not be where he is today if it were not for the wisdom, experience, and money inherited from his father, who was himself in the business.

–Christopher Siegle
Pompano Beach, Fla.

I SUGGEST WE EMBRACE a fresh generation of hedge fund managers by recalling that numerous titans of today's hedge fund community established themselves when they were mere twenty-somethings. As a green corporate associate at Cadwalader, Wickersham & Taft in the 1980s, I had the pleasure of drafting the offering memo for Paul Tudor Jones II's first hedge fund (promoting a fundamental trading style based on his successful cotton trading), conducting due diligence at John W. Henry & Co.'s office in Newport Beach, Calif. (jammed with shiny new computers generating orders for his technical trading), and structuring products for Ken Tropin while at Dean Witter (principal-protected, multistrategy, and multimanager funds). Innovations pioneered by these three gentlemen at the inception of their illustrious careers still underpin a substantial segment of the trillion-dollar-plus hedge fund w

Two "toddlers" cited in the article the offspring of active hedge fund ticipants, confirming that the indu and its pioneers have aged grace while diversifying their portfolios.

–Gary Rin
Chappaqua,

WHEN IT COMES TO MEDICATIONS ONE SIZE DOES NOT FIT ALL

"HOMEGROWN HORMONE ther How safe?" (News: Analysis & Comm tary, June 26) contains inaccura omissions, and mischaracterizat about the nature of pharmacy compo ing, its practitioners, and its regulato

The article ignores two critical f First, the knowledge and skills of a pounding pharmacist can be extre valuable, even life-saving. Million Americans have unique medical needs mass-produced, one-size-fits-all d from pharmaceutical manufacturers not meet. Some patients need extre small dosages, liquid dosage form medication delivery systems that ar available from manufacturers. Secon practice is heavily regulated through boards of pharmacy, national stand and guidelines. Overlooking these the article inaccurately attributes much authority to the Food & Drug ministration, which oversees pharma tical manufacturing, not pharmacy pounding, and implies that compou medications are never necessary.

Furthermore, the article quotes independent experts, all critical of pounding. What is missing is discl of the affiliations of these experts. have ties to Wyeth Pharmaceutica pharmaceutical manufacturer callin FDA action against compounding macists), and the third is a profess lobbyist for other anti-compoundin terests. Finally, the article broadly ligns the entire pharmacy professio accurately asserting that compou medicines such as bioidentical horm is illegal. In fact, compounding is a standing and basic component of macy practice.

–L.D. King, Executive Vice-Pres
International Acade
Compounding Pharm
Sugar Land

Editor's note: The letter was co-sign John Gans, American Pharmacists A Bruce Roberts, National Comm Pharmacists Assn.; Rebecca S National Alliance of State Phar Assns.; and John Feather, American ety of Consultant Pharmacists.

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Technology&You

BY CLIFF EDWARDS

Cool Player, Tepid DVDs

Ten minutes into watching *Ultraviolet*, a bad 90-minute music video tryin to pass itself off as a good 90-minute movie, I had had enough. Some would argue the plot synopsis should have been a warning: "A beautiful vampire in a futuristic world has to protect a boy, who is in fact a secret weapon: the cure for all the humans transformed into vampires."

Why didn't I just walk out? Because I was sitting comfortably on my couch at the time, preparing to write a review of the snazzy new DVD machine that was playing the movie. Samsung's BD-P1000 Blu-ray player is the first in a new category of high-definition DVD gear. Nearly every consumer-electronics company soon will be producing Blu-ray equipment, with the notable exception of Toshiba and RCA. They belong to a competing camp with a format called HD-DVD (Technology & You, July 24).

Priced at $999, the Samsung player costs about $400 more than rival HD-DVD machines, which went on sale in May. Realizing that it would occupy the high end of this niche, at least for now, Samsung seems to have put a lot of thought into design and usability.

The unit is a svelte 9.3 pounds, with a glossy black finish and silver accents on the front panel. The onboard display window and single control button for play/pause, fast forward, rewind, and stop light up in blue. Another nice touch: The front panel hides the slots for plugging in memory cards that contain your personal pictures. In addition to playing high-definition Blu-ray movies—just a handful of titles, at this moment—the Samsung will play anything in your old DVD collection. (Some of these movies may look slightly better than they would on a regular DVD player, but only true Blu-ray discs can take advantage of the machine's power.) My one quibble with the Samsung was the flimsy-looking remote, which did not include a backlit display for use in darkened rooms.

Samsung's Blu-ray player is crying out for good content

SAMSUNG BD-P1000

SAMSUNG BUNDLES AN ALL-IMPORTANT cable known as HDMI, which runs from a connector on the back of the player to your TV set. I hooked the player to a Sharp HDTV with a 65-in. liquid-crystal display and also to a Samsung 56-in. HDTV that uses digital light processing chips. Both these TVs deliver the sharpest possible HD images—what the technorati like to call 1080p. With this level of screen size and picture resolution, you feel as if you've just undergone Lasik eye surgery. Blurr backgrounds come into focus, colors look more vivid, and y generally see more details in the picture than ever before. It can actually be distracting. Watching the 2005 comedy *Hit* I found myself scrutinizing the individual hairs on Will Smith's goatee. In addition, some movies let y take advantage of Blu-ray's special features, su as changing the camera angles. The format als offers subtitles in many more languages than current systems, including Thai and Russian.

Not everyone has a high-end, 1080p HDTV hand. In fact, most of the sets in stores right n display pictures at a somewhat less breathtaki 720p. But don't get too hung up on the technic ities. Surveys show that many viewers watchin at a distance of 10-15 feet can't distinguish between these two technical specs. Screen size, on the other hand, does seem to matter. People watching on TVs smalle than 50 inches may not grasp why Bl ray movies are superior to ordinary DVD

I admire almost everything about the Samsung player: the Apple-like packaging and design, the amazing picture and sound quality. But it's hard to overlook the backward thinking that has marred both Blu-ray and HD-DVD o ferings. I'm talking about content. *XXX: State of the Union*, *Dukes of Hazzard*, and *Kung Fu Hustle* don't make my list of the top 10 movies of all time. There are a few A-list titles suc as *Crash* and *Terminator 2*, but for now, the studios seem intent on unloading their stinkers on a captive audience. Com fall, it looks like they will have more interesting titles availal

The main purpose of the players should be to showcase great, high-definition content, and thus spur sales of hardware, movies, and TV shows. Until the entertainment indus gets this piece of the puzzle right, I'll be just as happy to wa birds flying in high definition on Discovery's HD channel.

BusinessWeek online Steve Wildstrom is on vacation. For past columns and reviews, go to Technology & You at businessweek.com/go/techmaven/
For Cliff Edwards' video report about Blu-ray on *BusinessWeek Weekend*, go to businessweek.com/go/tv/blu

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200630

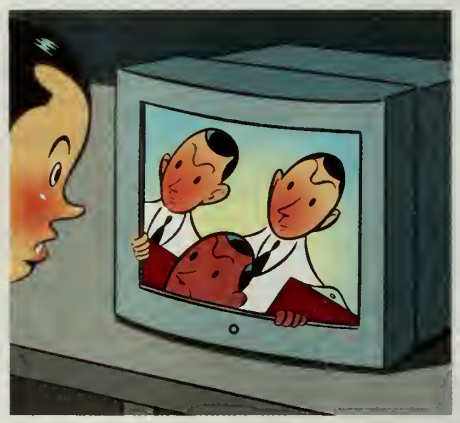
MediaCentric BY JON FINE

Media, Marketing, and Advertising in the 21st Century

Counting Every Last Eyeball

This is a column about media measurement, which is an extremely dull topic until you realize it largely dictates how more than $250 billion worth of advertising gets spent in the U.S. each year. ¶ So it is a Very Big Deal that Nielsen Media Research, which holds a de facto monopoly over television ratings, will begin measuring the audiences of commercials as well as of

programs. Or at least this is a Very Big Deal among media geeks. Many say Nielsen's initiative is too blunt a tool, since in its initial form it will provide only average ratings for commercials within an entire program. It won't measure specific commercial blocks—"pods," in adspeak—or individual commercials themselves.



This point rankles some key media buyers. Ratings for individual commercials are common in Europe and Asia, which makes this another instance in which the state of the art for American media trails the rest of the world. Still, Nielsen's ad ratings are one of many developments that may drag the U.S.'s traditional media measurement into the late 20th century, if not into the up-to-the-moment realm of the Web. Other next-generation moves promise more detailed data on magazine and radio audiences. Also lurking on the horizon: Readership.com, a new way to measure print consumption and readers' "engagement"—an ad-world buzzword of late—and Project Apollo, another Nielsen service that will track, more or less, a consumer's complete in-home and out-of-home media usage.

All of which gets into the realm of quantum physics: How will the new observations affect what is being observed? Network heavies already admit Nielsen's commercial ratings data—slated for a November debut—will change how ads are bought and sold in next year's upfronts, that rite of spring in which deals are struck for much of a season's TV ad inventory. Expect many other textures of TV as we know it to change as well.

MOVIE COMMERCIALS STAY ON TV. Ad and TV execs say movie ads reliably keep viewers on the couch and tuned in. Since movie promos will juice overall commercial ratings, they make all inventory more valuable—which means network suits will strive mightily to keep them. (As they'll strive to keep studio suits from finding this out, lest film executives press for better deals.)

THE AD ITSELF JUST GOT MORE IMPORTANT. Laura Desmond, the CEO of the media buying firm MediaVest USA, suggests it's no accident that non-U.S. commercials rake in awards at international ad gatherings: Ratings for commercials abroad force admakers to scrap for viewers ju like programmers, thus spurring creativity.

BUT DON'T EXPECT ADS TO GET BETTER. "Good," in terms of high ratings right n means squirmfests like *America's Got Talent*. And the last I checked, no one h brought back the fanatically acclaimed but poorly rated *Arrested Development*.

PITY THE POOR NETWORK EXECUTIVE. Media buyers are about 30 seconds aw from demanding ad placement in spec pods, since the first and last spots are considered the best-watched. One top network executive points out that the only shows now structured like this are the Oscars and the Sup Bowl. Selling individual ad placements on every program every night equals a logistical nightmare. Add on demands to make ad pods shorter and mor frequent, which media buyers s will lead to better ratings. Now imagine telling the producers *24* and *Desperate Housewives* th they have to rework episodes t accommodate such demands, a you almost start feeling sorry f the networks. Until they unleash...

Nielsen's new ad ratings will change the feel of television as we know it

THE RETURN OF SOAP OPERA NATION. The suits say ads are be viewed during live events and shows that layer on multiple cliff-hangers. This makes the new network MyNetworkTV's decision to spotlight short-run *telenovela*-style programs—t is, ultra-sudsy, highly histrionic fare shown nightly instead weekly—look prescient. (As does that network's plan to wra mini-storylines around its ad pods.) If the thought of a *Gen Hospital*-ized TV world horrifies you, well, did you really thi better media measurement would result in better media? ■

BusinessWeek online For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia

JAMES C. COOPER

f Oil Keeps Flowing, Growth Will, Too

ipital spending and exports will keep the economy moving ahead

U.S. ECONOMY Globalization brings everything closer to home—cluding geopolitical instabilities and the risks they create for onomies and markets. Once again, tensions in the Middle East have iled over, this time between Israel and the Hezbollah in Lebanon, d worries about a wider involvement by Iran and Syria have tacked et another risk premium to the price of oil and wn the financial markets for a loop.

s a result, the economic outlook has come under a cloud of uncertainty. Just when consumers and nesses seemed to be coping—if not so easily—with oil 70 per barrel, the concern now is oil at $80 or more, not one hurricane has even formed yet. Note that at end of 2005, *BusinessWeek* asked more than 50 casters where the price of oil would be at the end of 6. The average expectation: about $54 per barrel.

he price of oil is crucial to the outlook right now use its impact could extend far beyond the consumer or's grumbling about $3-per-gallon gasoline. It is also ing to inflation pressures outside of energy, as seen in e consumer prices and as noted by Federal Reserve irman Ben Bernanke during his congressional mony on July 19. That could portend even higher rest rates that would affect the economy broadly.

o far, data through the second quarter are ouraging for the second half of the year. As Bernanke arked: "Although growth in household spending has ved, other sectors of the economy retain considerable nentum." Steady strength in capital spending and orts is waiting in the wings to take up much of the k from slower consumer spending and housing. But il fiasco could thwart that script.

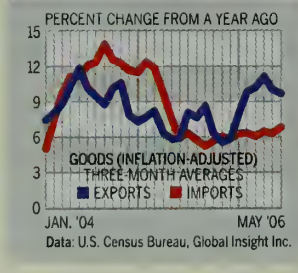
he real danger is not so much higher oil prices per se a sustained supply shock resulting from a major rruption in the supply of crude. Hurricane Katrina is ini-example, but those supply problems lasted weeks, months. A long-term disruption would restrict duction and demand, while generating uncertainty ng businesses that would cut deeply into capital nding and hiring, not just in the U.S. but in all oil-suming economies. At the same time, it would greatly ease inflationary pressure, leaving the Fed in a no-win ation of rising inflation and a flagging economy.

R NOW, THAT'S ONLY a worst-case scenario preying nvestors' minds. As long as crude remains free-ing, the danger of yet higher oil prices is not as great, n the continued evidence of strong supports beneath . and global demand.

Those supports were clear in the second quarter. Despite oil at close to $70 for nearly all of the second quarter, economic growth last quarter appears to have held up surprisingly better than many forecasters had expected, after oil prices jumped from below $65 in March to more than $75 in April.

The Bureau of Economic Analysis will report its first estimate of second-quarter real gross domestic product on July 28. Many economists are upping their earlier growth estimates based on recent reports on exports, industrial production, and inventory growth. Even though consumer spending and housing slowed last quarter, the overall economy appears to have grown in the neighborhood of 3%.

BOOMING EXPORTS ARE OUTPACING IMPORTS



Data: U.S. Census Bureau, Global Insight Inc.

Consumer spending was hardly weak, though. Based on the monthly data on retail sales, real household spending appears to have grown at about a 2.5% annual rate. That's only half the pace in the first quarter, but it's still a pretty respectable gain given the surge in gas prices and rise in interest rates. And the spike in tax receipts in the second quarter, reported by the Treasury Dept., suggests that household income growth remains strong.

IN THE SECOND HALF, consumers are unlikely to supply the economy with much oomph, but that will not be the case for exports and capital spending as long as oil keeps flowing. In fact, one of the biggest surprises this year has been the power generated by exports. Shipments abroad grew so strongly in the second quarter that the trade deficit, after adjusting for inflation, appears to have narrowed, making a small positive contribution to last quarter's economic growth.

The May trade data show that exports of goods and services jumped 2.4% from April, the largest monthly gain in a year and a half. Looking only at the important

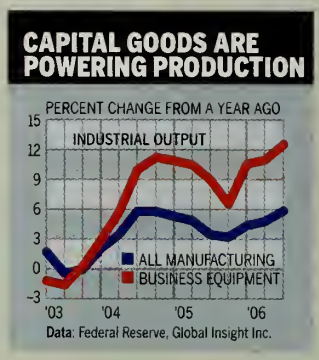
goods sector and adjusting for inflation, exports so far this year are up 10% from last year, considerably faster than the 6.2% increase in goods imports (chart).

Exports are benefiting from strong global growth and a more competitive dollar. The broad trade-weighted greenback is down nearly 14% from its peak in early 2002. The decline has been large enough and has lasted long enough to alter the buying patterns of foreigners. In fact, economists at JPMorgan Chase & Co. calculate that the U.S. share of world exports has now stabilized after a long period of decline, thanks mainly to the lower dollar and overseas growth over the past year of about 4%, faster than the 3.6% pace in the U.S.

Barring a major oil shock, strong growth abroad seems likely to continue. Although central banks in Europe and Japan are tightening policy, including Japan's first interest rate increase in six years, financial conditions remain relatively easy. The inflation-adjusted, or real, policy rate remains considerably lower in Europe than in the U.S., and real rates in Japan will remain negative for many months. Asian economies generally remain strong, supported in part by China's booming economy, which grew 11.3% in the second quarter from the previous year.

A GLOBAL BOOM IN CAPITAL GOODS, as businesses in the U.S. and overseas expand by investing in new plants and equipment, is the main trade story. During the past three years, the volume of U.S. trade in capital goods—exports plus imports—has ballooned by 45%. Adjusted for inflation, U.S. exports of capital goods have surged 46%, and imports coming into the U.S. have grown 47

U.S. manufacturers are reaping many of the benefits seen in June's broad 0.7% advance from May in factory production. Output grew nearly as fast in the second quarter as it did in the first. Over the past year, production has increased a healthy 5.9%, powered by a 12.3% advance in outp of business equipment with high-tech gear, su as computers, telecom equipment, and semiconductors, up 21.9% (chart).



Manufacturers offer key illustration of why U.S. businesses are expanding their operations. Over the p year factory output ha grown more than twic fast as industries have added to their capacity to produ As a result, the rate of capacity utilization in June hit a six-year high of 81.1%.

Clearly, oil at $80 per barrel would further depress demand in the second half. But for the past two years, consumers and businesses have weathered the effects costlier energy amazingly well, as incomes and profits have grown. If $70 oil hasn't sent the economy into a recession, then $80 oil won't, either. If someone turns the spigot, however, that's another problem entirely.

PROFIT MARGINS

The Big Squeeze Is On

CORPORATE AMERICA'S amazing pace of profit growth is ebbing. In the face of higher energy and materials prices, a tighter labor market, and slower economic growth, companies are finding it harder to sustain current profit margins. Not only will that have an impact on earnings, but it might also affect job growth.

More companies saw profit margins deteriorate, according to a National Association for Business Economics second-quarter *Industry Survey*. Out of the 170 businesses surveyed, those that saw margins rise outnumbered those that reported a fall, but the difference was the narrowest since 2003. In the finance and goods-producing industries, including manufacturing and construction, more respondents saw margins shrink than widen.

An inability to fully pass along higher input costs, such as energy and raw materials, is catching up with companies. The share of businesses able to raise prices in the second quarter was 27%, while nearly two-thirds said that materials costs rose. Going forward, just over a third of those surveyed will try to lift prices, vs. 62% who see costs growing.

This trend is echoed in Morgan Stanley's latest analyst survey. The share of analysts who said the companies they cover saw margins squeezed by higher material or labor costs hit 36% in July, up from 29% in June.

The latest figures on inflation validate what businesses and anal are saying. In June, increases from year ago in wholesale prices of cru and intermediate goods ran at mo than twice the 4.3% pace for consumer price advances.

Because companies have been to maintain solid productivity gai and cut costs elsewhere in order t margins, hiring and capital spend have been solid in most industries But hiring could slow as margins begin to narrow. The NABE survey showed that only 31% of respond plan to add workers in the comin months, down from 44% in the fi quarter. Meanwhile, investment plans for the year remain upbeat companies strive to squeeze out even more productivity gains in attempt to preserve past margin improvements.

-By James Mehring in New

Aaron Parry
Executive Producer
Paramount Pictures

Julia Pistor
Executive Producer
Nickelodeon Movies

Mike Braico
Account Executive
Sun

Steve Oedekerk
Writer/Director/
Producer
Omation

Anthony Lopez
Lead Systems
Administrator
Omation

Otis
Movie Star

Share the creative process. Paramount Pictures, Nickelodeon Movies and Omation Animation Studios brought top industry talent together for the production of their animated film *Barnyard*. As the artists began the intensive process of 3D rendering, they realized that their infrastructure could use a helping hand. Enter the powerful x64 servers from Sun. With the time and resources they saved, the rendering of the movie was completed in 6 months—warp speed in the animated-film business. The results are extraordinary. The power is the collaboration. The network is the computer.™ Share.

sun.com/x64

Sun microsystems

AMD 64 Opteron

share

The Business Week

News you need to know

EDITED BY ERIC SCHINE

Attack, Counterattack As **Israel** battled Palestinians in Gaza, Lebanese **Hezbollah** guerrillas captured two Israeli soldiers in a cross-border raid on July 12, setting off the worst Arab-Israeli violence in years. As of July 19, more than 300 Lebanese and 29 Israelis have been killed. **Lebanon's** economy is in tatters after Israeli air raids inflicted at least $2 billion in damage. But the bigger danger is that the conflict will spread. At press time, that looked unlikely. But if Syria were to be drawn into the conflict, Iran could come to its ally's defense with a cut in oil production. That could boost the price of crude to $100 per barrel or higher.

See "Beyond Iran's defiant face," page 31

Fast-Food Fuel **McDonald's** loves soccer and Johnny Depp. The No. 1 burgers-and-fries chain said its second-quarter earnings rose 60% to $835 million from a year earlier thanks largely to tie-ins to two big global hits: the World Cup tournament and **Disney's** *Pirates of the Caribbean*. The chain got another extra large order of cash —$125 million—from the spin-off of its **Chipotle Mexican Grill** unit and more help from the booming breakfast biz, perked up by a new line of premium coffee.

Encouraging Ben **Fed Chief Ben Bernanke** has a bad habit of roiling markets. But this time he managed to avoid the accidental fireworks his comments have tended to set off. At his semiannual testimony before Congress on July 19, Bernanke said the central bank is forecasting slightly l er economic growth and higher inflation than earlier e mates. But he later added that he did not see a recess "as very likely." **The Dow** rose by 212 points and b yields fell as investors bet on a pause in rate hikes.

ONLINE *See "Bernanke smoothly cheers the Stre www.businessweek.com/go/*

Bully for Brokers Brokerage stocks surged on a b earnings report from **JPMorgan Chase,** up 37% for the s ond quarter, and optimism over Bernanke's upbeat c ments to Congress. It was in marked contrast to how week started off—with traders selling shares of **Me Lynch** after spotting bearish tea leaves amid a 44% ea ings gain, and **Citigroup,** whose 4% profit gain failed make Street projections.

Winging It Can **Airbus** pull out of its nose dive? Conced a "serious problem" in customer relations, the company nounced on July 17 that it will build a new, more effic widebody jet. The plane, which Airbus is calling the A XWB—short for extra-widebody—replaces an earlier des that had never gone into production and had sold po against **Boeing's** 787 Dreamliner. Airbus will offer the plane in three sizes in hopes of competing not only aga the 250-seat Dreamliner but also against Boeing's la 777 jets, which are grabbing market share from Airl A340 model. Problem is the Dreamliner is set to enter s ice in 2008, four years before the first A350 XWB, and 777 is already on sale. Airbus also needs to iron out proc tion problems on its A380 megajet, due to enter service year.

ONLINE *See "Airbus eats humble pie at Farnborou www.businessweek.com/go/t*

Divided on Stem Cells Destroying life or curing ho ble diseases. Those are the far sides of the emotional bate over human stem cell research. Now the battle is tensifying. On July 18 stem cell proponents won a vic when the **Senate** passed a bill allowing federal support research using cells from unused embryos at fertility ics. Even though **President Bush** quickly vetoed the meas the Senate vote signals that proponents are gaining mentum.

ONLINE *See "The stem cell wars: A partial victo www.businessweek.com/go/*

GM Watch Give **GM CEO Rick Wagoner** a little credit. Ra than get into a spat with **Kirk Kerkorian,** the 10% GM st holder who wants the company to join in an alliance **Renault-Nissan,** Wagoner sat down on July 14 with Ren Nissan Chief **Carlos Ghosn.** The two talked freely about they might work together. That's a far cry from the everyone expected with Kerkorian back on June 30 w the billionaire investor first floated the idea of bringing two companies together. For now Wagoner has succe in defusing tensions, but stay tuned.

See "Renault-Nissan: Say hello to Bo," pag

wer Surge Here we go again. A heat wave, and the theast power grid is pushed to the max. Three years r the huge blackout, has anything really changed? l, yes. Investor-owned utilities have nearly doubled r annual investment in power transmission capacity e the low of the late 1990s. And last year **Congress** sed the first mandatory reliability standards for the in- try. But power lines are still heavily loaded—and an- er big blackout is still a real possibility.

e that, Steve Jobs Wouldn't it be cool to download vies to your PC, burn DVDs, and then play them on r TV? Now you can. **CinemaNow,** backed by **Microsoft** independent film studio **Lionsgate,** is starting with not-quite-recent flicks like **MGM's** *Barbershop* and y's *Charlie's Angels: Full Throttle.* CEO Curt Marvis s more studios will sign on soon. Another service, **ielink,** which is owned by five major studios, including ner Bros. and **Paramount,** says it will use **Sonic Solutions'** io Cineplayer to burn DVDs. The bet: burning DVDs boost film revenues at a time when DVD store sales slowing.

ONLINE *See "Coming Soon to a TV Near You?," www.businessweek.com/go/tbw*

k Who's Talking The big guns have come to the ue of the flagging **Doha Round** of trade talks. On July 17 le representatives from around the globe flew to eva at the urging of world leaders at the Group of ht summit in St. Petersburg, Russia. The persistent king point: agricultural subsidies and industrial tar- No miracle breakthroughs are likely, but at least the s are still alive.

Air Travel Delay of the Week

vid Carruthers bet big—and lost. On July 16 federal ents nabbed the CEO of **BetonSports.com** in Dallas while was changing planes en route to Costa Rica from Lon- n. The Feds are charging him with racketeering, con- iracy, and fraud. A day later a Fort Worth judge ordered e British-based site to stop accepting bets from the U.S. d to turn over a list of financial institutions it does busi- ss with. Carruthers has taunted e feds for years, making frequent ps to the U.S. to lobby for legalized line gambling. Still, the Justice ept.'s main target is most likely **ry Kaplan,** who launched Bet- Sports in the late '90s as a New rk-based sports book. After his ar- st in 1993 on New York gambling arges, Kaplan moved the operation overseas. By 2004, tonSports was legit in Britain, trading on the London change, and Kaplan was forced to cede control of the mpany, though he still owns a 15% stake. Justice has a rrant for his arrest, but Kaplan is living in Costa Rica.

CARRUTHERS

ONLINE *See "Justice gambles on Net crackdown," www.businessweek.com/go/tbw*

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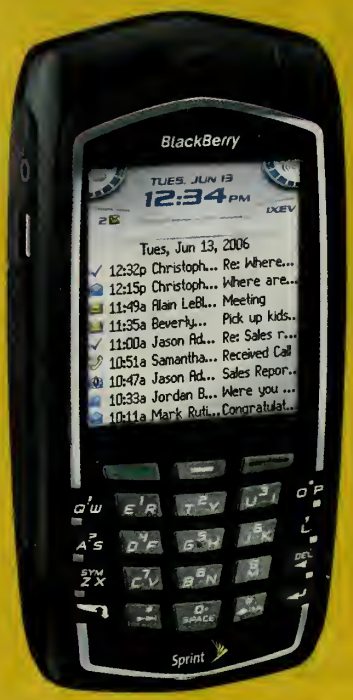

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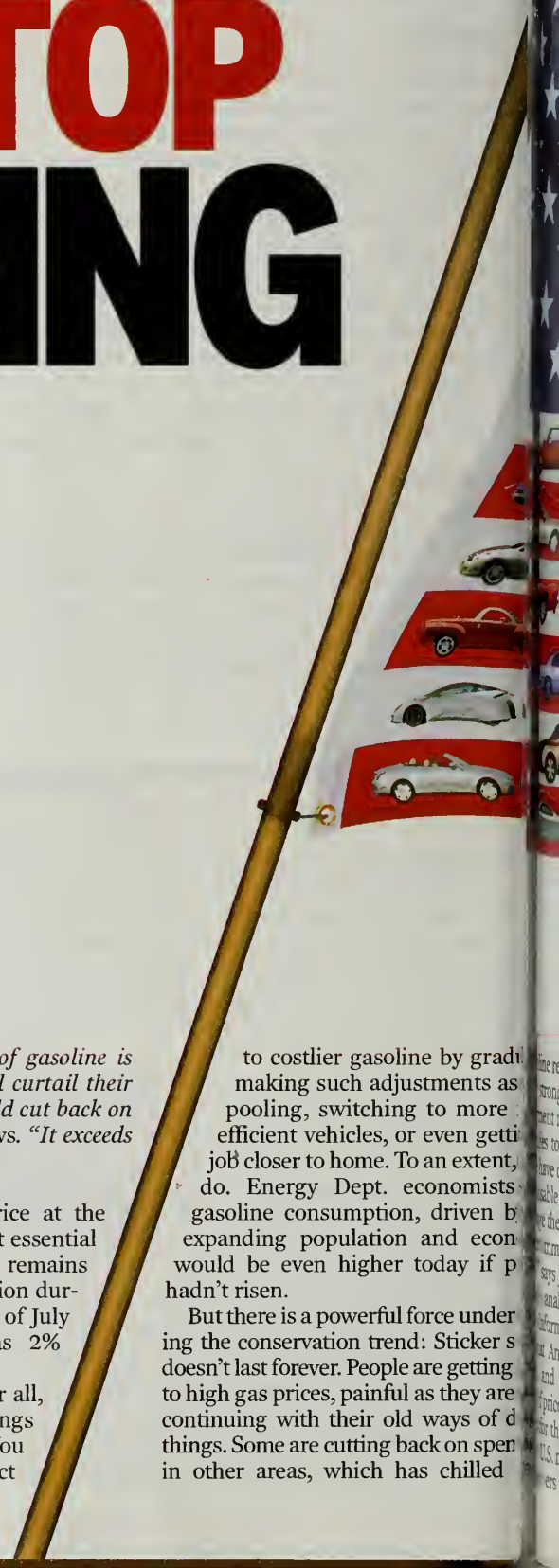
SKY-HIGH GAS

CAN'T STOP GUZZLING

Rising prices are supposed to curtail consumption. So why doesn't that hold true for American drivers?

BY PETER COY



From Tallahassee to Los Angeles, experts are worried that the price of gasoline is approaching a "breaking point." Any higher, they say, and drivers will curtail their driving sharply. "I believe that another 25¢ to 50¢ increase, people would cut back on consumption," a UCLA finance professor tells the Los Angeles Daily News. *"It exceeds the psychological barrier."*

THE DATE? MARCH, 2000. The price of gasoline back then? Around $1.50 a gallon.

It's something amazing to ponder as you broil in beach traffic this weekend. Gasoline keeps getting more expensive, but Americans keep buying more of it. They bought 10% more gasoline in the first half of 2006 than in the first half of 2000 even though the price at the pump rose 75%. It isn't just essential trips, either—leisure travel remains strong. Gasoline consumption during the week of the Fourth of July holiday this summer was 2% higher than a year ago.

Why the resilience? After all, when prices of most things rise, people buy less. You would think they would react to costlier gasoline by gradi making such adjustments as pooling, switching to more efficient vehicles, or even getti job closer to home. To an extent, do. Energy Dept. economists gasoline consumption, driven b expanding population and econ would be even higher today if p hadn't risen.

But there is a powerful force under ing the conservation trend: Sticker s doesn't last forever. People are getting to high gas prices, painful as they are continuing with their old ways of d things. Some are cutting back on spen in other areas, which has chilled

oline retail sales growth. But a reason- strong economy with a 4.6% unem- ment rate seems to be enabling many ilies to fill the tank with little strain. have consumers that have a lot more osable income and are less willing to nge their driving and purchase habits ccommodate the higher price of gaso- ," says John Maples, an operations re- ch analyst for the Energy Dept.'s En- Information Administration.

hat American drivers aren't cutting , and may not cut back drastically if prices go higher, has huge implica- s for the world oil market. That's be- se U.S. motorists are the single biggest sumers of petroleum in the world. They use more than 9 million barrels of gasoline a day. That's roughly a third more than the consumption of all types of petroleum by every home, car, and factory in China, the nation whose energy consumption gets all the attention these days.

"EXPENSIVE": A MOVING TARGET

THE RESILIENCE of the American motorist helps explain why oil is over $70 a barrel, or more than $50 a barrel above average production costs. Turmoil in the Mideast certainly plays a role (page 31). But the seeming immunity of both the supply and demand sides of the global petroleum market to price pressure looms large. On the supply side, oil companies are agonizingly slow to ramp up production to take advantage of the profit opportunity. On the demand side, consumption keeps growing in defiance of rising prices, and a key reason is that America's drivers are pretty near insatiable.

The ceiling on what Americans are willing to pay keeps rising: $3 seems to be the new $2. That's apparent in the monthly *Maritz New Vehicle Customer Study*, which asks car buyers what they think is an "expensive" price for gasoline. From early 2005 to early 2006, a period when the actual price rose 57¢ a gallon, buyers' definition of "expensive" rose by exactly the same amount, 57¢, remaining about a dime above the then-current price. Buy-

ers' definition of an "acceptable" price went up 37¢. "That says to me that there's habituation, though not complete habituation," says David S. Ensing, director of research and development for the automotive research group of Fenton (Mo.)-based Maritz Inc.

50 BUCKS A POP Manhattan's Parker won't give up his weekend drives

There's a myth fed by the news media that Americans are hunkering down and conserving gasoline the way families in World War II planted vegetables in victory gardens. More typical is Scott Parker, 36, of Manhattan, who fills up his Nissan XTerra SUV three times a week at around $50 a shot. Parker enjoys road trips on weekends. And although there is a commuter train to Norwalk, Conn., where he works as a marketing director, he prefers to drive. Says Parker: "At the end of the day, I'd rather be on my own schedule." The extra cost of gas goes onto his credit-card balances, which he plans to pay off with his end-of-year bonus. "After I fill it up I'm probably upset for a while, and it passes," he says.

The healthier the finances, the smaller the reaction to costly gasoline. Leonard A. Mintz, 71, of Norton, Mass., who made his money in the plastics machinery business, just finished an 800-mile trip through the Northeast in his 515-hp, bus-size Newell Coach Corp. recreational vehicle. Features include heated granite floors, a full-size washer and dryer in the master bathroom, and a tow for his GMC Envoy SUV. Miles gallon: 6. Concern: zilch. Says Mintz: "W just doing the things we normally do."

Low- and middle-income fami seem to be doing most of the conserv by necessity. "Our life has changed matically," says Jody Kendall, 28, an tomotive technician in Mishawaka, To save gas, he leaves his 2002 Pon Bonneville at home and gets a rid work from his wife, Alison, a waitress. gether they make about $50,000 a ye

Energy Dept. economists estimate a permanent increase of 10% in the p of crude oil causes a 0.6% decreas gasoline consumption over two years. long-term impact is supposedly bigge cause people have more time to adjust.

REFINING CAPACITY

The Hazards Of Hitting the Gas

BY MARK MORRISON

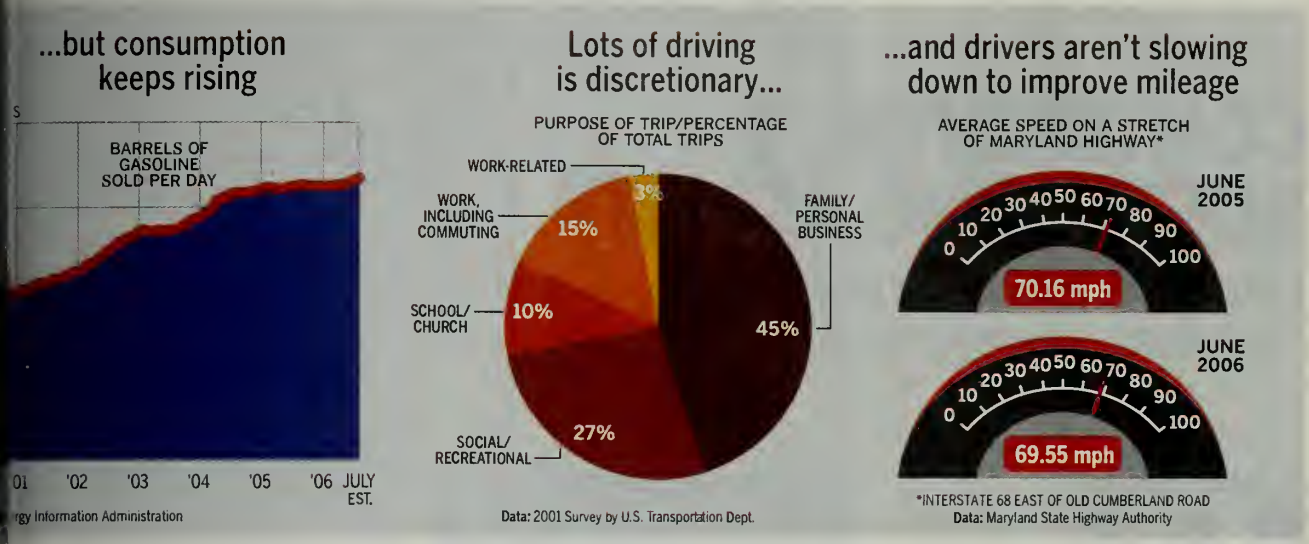
Two quick ways to reduce prices at the pump: lower the cost of oil and make more gasoline. By themselves, refiners can't do much about the first one. As for the second option, they're also constrained. There's just not enough refining capacity in the country. In June, U.S. refineries were cranked up to 93% of capacity to gear up for the summer peak in gas demand. Meanwhile, they've reported round after round of eye-popping profits because the bottleneck gives them such enviable pricing power.

While consumers fret over a capacity shortage, before long the industry could be staring down just the opposite scenario: overcapacity. Since 1990 incremental additions have nudged refining capacity from 15.5 million barrels per day to today's 17 million. But over the next five years, refiners have plans to spend billions of dollars to add another 10% to their capacity. That's about double the expected increase of 5% in demand for products like gasoline in that same period, figures Aileen Jamieson, a Wood Mackenzie Ltd. consultant. All of the announced projects would easily cost more than $20 billion; ConocoPhillips (page 82), the second-largest refiner in the U.S, alone will shell out $5 billion by 2011 to increase output up to 15% at some plants.

The building boom isn't confined to the U.S. Saudi Arabia and Venezuela are among international players that are planning big-scale refineries capable of making products to sell here. Already the U.S. imports about 10% of its gasoline. That figure shot up mor than 18% in the first half of this year because of strong demand and limitations on output from damage done by Hurricanes Rita and Katrina.

For the moment industry executives aren't sounding the alarms, at least publicly Valero Energy Executive Vice-President Ric Marcogliese points out that historically not

(TOP LEFT) CHRIS CASABURI; CHARTS BY ALBERTO MENA/BW



actual response has been less than that. e've hardly picked up any sensitivity," s Maples, the Energy Dept. analyst.

OKED ON HORSEPOWER

BITS DIE HARD. Highway officials in ryland and Texas, which compile data driving speeds, say they see scant evi- ce of slower driving, even though ac- ding to the Energy Dept. every 5 mph drive above 60 mph is equivalent to ing an extra 20¢ a gallon for gas. ghs Dinah Martinez, spokeswoman for uston TranStar, a consortium of trans- tation agencies: "This is Texas. If we e traffic slowdowns, it's not because y want to. It's because there's a wreck." Americans aren't ready to end their love affair with cars that go vroom-vroom. Sure, sales of large and luxury SUVs fell 15% in the first half from a year earlier, while sales of compacts rose 8%, according to Edmunds.com Inc. But vehicles of all sizes are getting bigger engines, so there has been no improvement in overall fuel efficiency. On July 17, the Environmental Protection Agency announced that model 2006 cars and light trucks are the fastest and heaviest since 1975. Their average real-world fuel economy is 21 miles per gallon, lower than the 22.1 mpg average of 1987-88, nearly 20 years ago. So much for the idea that energy independence is America's "moral equivalent of war."

If oil shoots to $100 a barrel, consumption could drop noticeably, as it did after Hurricane Katrina last year, when prices rose 46¢ in one week. But if history is any guide, even gas of $4 or $5 a gallon might not force dramatic, lasting changes in American consumption patterns. That breaking point we've been looking for? Maybe there isn't one.

–With Greg Hafkin in New York and Ann Therese Palmer in Chicago

BusinessWeek weekend For more on oil and gasoline prices, watch our weekly TV show, *BusinessWeek Weekend*. Check your local listings or go to businessweekweekend.com and type in your Zip Code to find when and where it airs in your area.

all announcements lead to actual construction. He expects some of the current industry exuberance to wane. In fact, Tesoro just announced big cost overruns in its expansion program, and canceled a $250 million addition to its refinery in Anacortes, Wash.

But there are still more signs of frothiness than caution in the industry. According to Wall Street sources, half-a-dozen bidders, including Conoco and Petrobras, are competing to buy a large refinery near Houston, jointly owned by Lyondell Chemical and Citgo. The deal could fetch $5 billion, which translates to $20,000 per barrel of capacity, double the rate a couple of years ago. The refining industry saw miserable years in the 1990s, when excess capacity led to razor-thin margins and dozens of refinery closings. But it appears that memories are getting short.

AIRLINES

CONTINENTAL'S SURPRISING ASCENT

Like other major carriers, it has figured out how to prosper in an era of pricey fuel

BY ROBEN FARZAD

WITH THE PRICE OF oil hitting an all-time high, double where it was just two years ago, investors are dumping shares of any company that stands to be hurt by higher energy costs. Retailing stocks are selling off on fears that high gas prices will squeeze consumers. Ditto, restaurants. Even Yum! Brands, purveyor of the 59¢ taco, has been marked down.

You'd think big legacy airlines, the stock market's perennial D-students, would be suffering disproportionately, given how much fuel they guzzle. Quite the opposite: Continental Airlines, which has twice been in bankruptcy, has seen its stock price triple in 10 months. Shares of AMR, parent of American Airlines, and US Airways Group, each have doubled.

It's not that the big guys have hedged themselves particularly well against rising oil prices. Discount king Southwest Airlines Co. is the best hedged, having locked in most of its fuel through 2009 at under $40 per barrel, according to Cathay Financial in New York. Yet its shares are up only 20% since last September.

Out of nowhere, legacy airlines have figured out how to make a buck despite surging fuel costs. "Industry fundamentals have not been this good in years," says Merrill Lynch & Co. airline analyst Michael Linenberg. Their secret: packing carefully chosen fleets and routes with passengers who will accept fuel surcharges and higher fares.

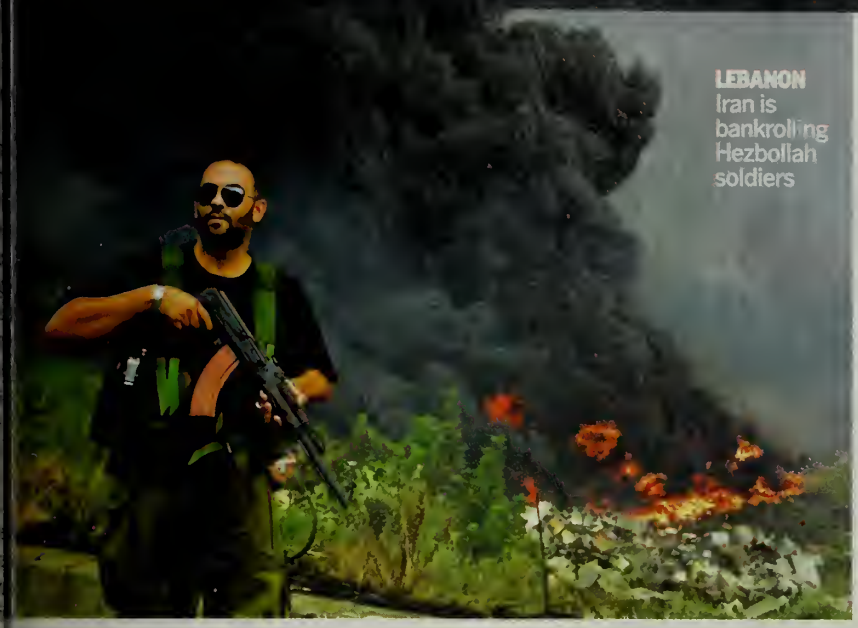
For once, major carriers are using their natural advantages to beat discounters. Southwest, JetBlue Airw Corp., and others rely too heavily on gressive expansion and race-to-the-bott pricing, says Raymond E. Neidl, an air analyst with Calyon Securities in N York. Neither is a particularly attractive tion right now. In fact, Southwest rece did the unthinkable, pushing throug $10 increase to its highest one-way f The major carriers, by contrast, are o mizing their big route networks and inventories to squeeze the most profits of them. Continental, whose shares cently changed hands at 30, up from 9 fall and 4 in 2002, has been especially pressive. It's running planes at 85% pacity, vs. 78% three years ago, and e hit 94% on the last day of June. By ke ing its seat count steady as travel dem climbs, it can command higher ti prices, particularly with the discoun easing up on their expansion plans.

PLENTY OF CASH

CONTINENTAL'S improvements ar all on the revenue side, though. Leg carriers are famously bloated, but Co nental was able to w $500 million in wage benefit cuts from its wor last year. It's a classic str gy: Cut costs now so that revenue gain will send pr jumping. Smart balance-sheet mana ment has allowed Continental to stock more than $2.6 billion in cash; it rec ly retired $100 million in debt due year, avoiding a high interest expens

According to investment bank Continental is the only carrier sports the four-way combination of pacity improvement, a diversified work of routes, popula with higher-paying busi travelers, and strong g profit margins. It ba 25% of each additi dollar in sales as p And none of its dom routes represents n than 1% of revenue.

All told, analysts expecting Continenta report second-quarter earnings of $1. share on July 20, more than double take the year before. It's on track to s from a $2.92 loss in 2005 to a $3.13 it this year. And those estimates c prove conservative if oil prices start t cline and Continental takes advanta packed planes to ratchet prices higher. "Hopefully," says Neidl, "th smart enough to do that."



LEBANON Iran is bankrolling Hezbollah soldiers

DDLE EAST

EHIND IRAN'S EFIANT FACE

il money flows, but business confidence nd foreign investment are flagging

STANLEY REED

FOR IRAN'S PRESIDENT Mahmoud Ahmadinejad, it's an invigorating moment. The nation's militant client Hezbollah, in Lebanon, has been bombarding Israel with Iranian-supplied rockets. hadinejad's government coffers are ing with oil and gas revenues expect- o hit $60 billion this year, making 's $180 million in aid to Hezbollah uts in comparison. Indeed, Ah- linejad has felt emboldened to stand to the U.S. and Europe. They are atening U.N. sanctions if he doesn't up enriching uranium, which they will lead to nuclear weapons.

ike Venezuela's Hugo Chávez, Ah- linejad can count on his ocean of oil— record prices—to keep him feeling on of the world. Look a little closer, how- , and the picture is more complex. y Iranians, especially businesspeople, larmed at the government's course of n. Hezbollah's clash with Israel has htened their concerns. "This has given the rest of the world an excuse" to beat up on us, says a prominent Iranian executive.

Business confidence in Iran has been flagging since Ahmadinejad won the presidential election a year ago. Industrialists are dismayed because politically, the President has taken Iran back to the bad old days of confrontation with the West. At the same time, his economic and fiscal policies have proved to be an incoherent hodgepodge. Ahmadinejad pours 6% of gross domestic product into subsidies for food, fuel, and other essentials, a move applauded by ordinary citizens. But a near-50% boost in the minimum wage last winter made it tougher than ever for Iranian factories to compete against Chinese imports. That forced substantial layoffs, adding to double-digit unemployment, now at 14%.

DEEPENING DISARRAY

BEFORE AHMADINEJAD'S election, Iranian private business was ready to ramp up investment. Now money is flowing out of the country, as evidenced by the 30% fall in the stock market over the past 18 months. Foreign business interest has also cooled. BP PLC, which wanted to be a big player in Iran, says it isn't looking for new business in the current climate. Banking giant UBS says it has stopped doing any business with Iran-based customers.

Even the oil industry has seen its share of troubles. Although Iran remains the No. 2 OPEC producer behind Saudi Arabia, it has struggled to maintain its 4 million barrel per day production. Purges of the oil bureaucracy have deepened the disarray. An award of a $2 billion gas development contract to the engineering arm of the Revolutionary Guards sparked criticism that Ahmadinejad, an ex-Guard, sought to reward his buddies for their support.

Turmoil in the Iranian oil industry will eventually take a toll on production. And with expenditures rising, the economy could be vulnerable if the government keeps stifling the private sector. Partly in response to business concerns, Supreme Leader Ayatollah Ali Khamenei recently issued a decree authorizing privatization of some 80% of the massive state sector. The move sent a ripple of optimism through the business community, which would still invest if the leadership found a way out of various political impasses.

Despite their blustering, Iran's leaders have an interest in cooling things down. Iran would be hurt if sanctions are imposed to stop the uranium enrichment program. Yet whether the Iranians can compromise with the U.S. and Europe is tough to predict. That uncertainty leaves open the possibility of a military strike by Israel or the U.S., although most analysts think it's unlikely. Such a strike could lead to a cutoff of Iran's 2.6 million barrels of daily oil exports, sending prices into the stratosphere. "I don't think things will get that far out of hand," says Manouchehr Takin, senior analyst at London's Center for Global Energy Studies. "There isn't much leeway to compensate for the lack of Iranian oil." ■

–With Babak Pirouz in Tehran and Neal Sandler in Jerusalem

MASS APPEAL

IT'S ON THE TIP OF YOUR TONGUE

As more medicines take the form of "edible film," the market is exploding

BY ARLENE WEINTRAUB

THEY'RE LITTLE GREEN patches of film that melt instantly on your tongue, releasing bursts of minty breath freshener strong enough to wipe out all signs of that garlic shrimp you had for lunch. Sound familiar? They're Listerine PocketPaks, and they're made of a material that folks in the food industry call "edible film." Introduced by Pfizer Inc. in 2001, PocketPaks sparked a craze. Now everything from sushi to Sudafed is showing up on store shelves all wrapped up in melt-in-your-mouth film.

Consumers are lining up for the chance to stick out their tongues. Retail sales of edible film, at about $100 million a year today, are expected to hit at least $350 million by 2008, says James Rossman, a former maker of edible film who is now a consultant in Tampa. In 1999 sales were just $1 million, mostly from niche products such as the edible underwear that's a favorite gag gift at bachelor parties. "Listerine broke the market wide open," says Rossman—who, by the way, in 1974 had a hand in inventing some of the first edible undies.

Over-the-counter drugmakers are breathing new life into tired brands by pressing them into flavored strips. In 2004, Swiss pharmaceutical giant Novartis introduced Triaminic and Theraflu Thin Strips. This April it followed up with Gas-X Thin Strips, a new twist on a nearly 30-year-old brand. The Triaminic franchise now claims a 20% share of the pediatric cough and cold market—the first time since 1999 the brand has broken the 20% barrier. "Most of the growth has been driven by the Thin Strip," says Brian McNamara, a vice-president at Novartis Consumer Health in Parsippany, N.J. In the past year, retail sales of Theraflu and Triaminic strips were up 28% and 26% respectively, bringing in more than $19 million, according to Information Resources Inc.

Sales of Listerine PocketPaks, meanwhile, fell 20%. But even if the breath market turns sour, strips could prove appealing as a way of delivering drugs. Film strips dissolve quickly without requiring water. That's good news for elderly patients who have trouble swallowing and even better for kids who hate syrupy medicine. Plus, strips are discreet—a selling point for drugs such as Gas-X. "If you have a meal that you know is a precursor to a gaseous event, you can take a film and on your way," says Alexander M Schobel, CEO of MonoSol Rx, a War (N.J.) manufacturer of edible film. Sc Big Pharma companies are eyeing technology for more lucrative presc tion drugs, he reports.

LAPPING IT UP
Pets and kids are prime targets

SLY POOCH

PATIENTS WITH FOUR legs and fur r be the next target for drugs-on-film. bert Ahn, a veterinarian and spokesr for Hartz Mountain Corp. in Secau N.J., says his company is looking at ed film as an alternative to stuffing p down pets' throats. "Dogs and cats pill con artists," he says. "They h them under their tongue or in their and then spit them out when you're looking." Strips stick—and some dr can also be given at lower doses on fi because they are absorbed better thro the tongue. Ahn estimates that pet pl maceuticals represent a $1 billion mar

The risk is that consumers might buy into this film frenzy. It can be har mask a medicine's taste on film beca the strips are so small. And the novelt fect may wear thin. Hartz recently pu its mint breath strips for dogs off the r ket in the U.S. because they never cau on. (Ahn says, however, that they a "resounding success" in Japan.)

Declining breath-film sales haven't terred the food industry, which is finc all sorts of new uses for the technol Some meat manufacturers are using f to cure and glaze ham. There are e trolyte strips that athletes can consum lieu of sports drinks to fight dehy tion. Film might someday be use a moisture barrier, separating tomato sauce from the crust frozen pizza, for example, so crust stays crisp. "These films improve the quality and shelf li food," says Tara McHugh, rese leader for an Albany (Calif.) un the Agriculture Dept.

And get this: Matthew de E owner of Origami Foods Pleasanton, Calif., has develc films made of carrot, and tor with basil, which can be use place of seaweed to wrap su "Some people have an a sion to seaweed, or they want an alternative," de l reasons. Costco Whole Co. is testing sushi wra in de Bord's films at son its stores in Califo Wonder how that m play in Tokyo.

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The Young and the Vicious

You've heard that MySpace is dangerous for your kids, but what about for your business? Behold the summer of talking smack. Lots of interns and other summer employees have been logging on and dishing out on blogs and social networking sites about incompetent co-workers, negligent managers, and annoying customers like, uh, you. Others use the sites to gossip or defend the companies against negative comments. A number of companies have banned interns from blogging. But so far social networking sites have escaped most employee conduct codes. With more than 25,000 groups on MySpace's companies and co-workers section alone—including Publix Pimps, T.J. Maxx needs to die, and The Abercrombie is Evil Awareness Foundation—no company is immune. Here's a taste of what's out there: *–Kurt Soller*

GROUP NAME/ NUMBER OF MEMBERS	ENTRY	COMPANY COMMENT
AMC Worked Me 480	On management: "They're lazy b------- who pass the bill on to someone below them while they sit in their dirty little offices ordering more food or they sit on the loading dock with a cigarette for half an hour while the box office and concession stands are being pummeled and the ushers are on their radios calling for help to clean their sold out shows..."	Social networking sites are not official communication vehicles for AMC [Theatres], but we recognize th they exist. AMC encourages its associates to share concerns throug authorized company channels.
Best Buy Losers Club! 284	"Don't b---- about the long receipts. You know there's no way I can make them shorter and you really think Best Buy gives a s--- about trees? The only paper Best Buy cares about is the one with the dead presidents on them."	We're not going to pretend like we don't see what is out there, so we tr to get into the conversation.
Blockbuster Crew 260	"im angry at the fact that the corporate idiots cant find ways to make money without screwing the employees"	We don't believe many of the comments are an accurate reflectior of Blockbuster or of our thousands c high-quality employees.
The Disneyland Bitterness Convention! 332	"I hate how the company takes advantage of us and doesn't give a s---. We are basically disposable to them."	Tens of thousands of guests and cas members express their positive experiences visiting and working for Disneyland every day.
Home Depot 850	"I finally had enough of the stupidity, lack of communication and the inability to hire associates with a brain... you ask a question and all you get is a blank look, and this goes all the way to management."	The Home Depot respects the right associates to express opinions on th Internet....Any posting of confidenti information would be inappropriate.

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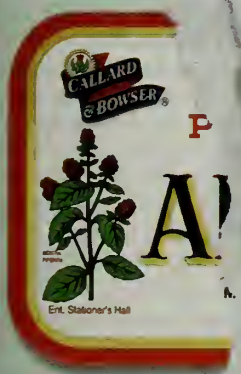

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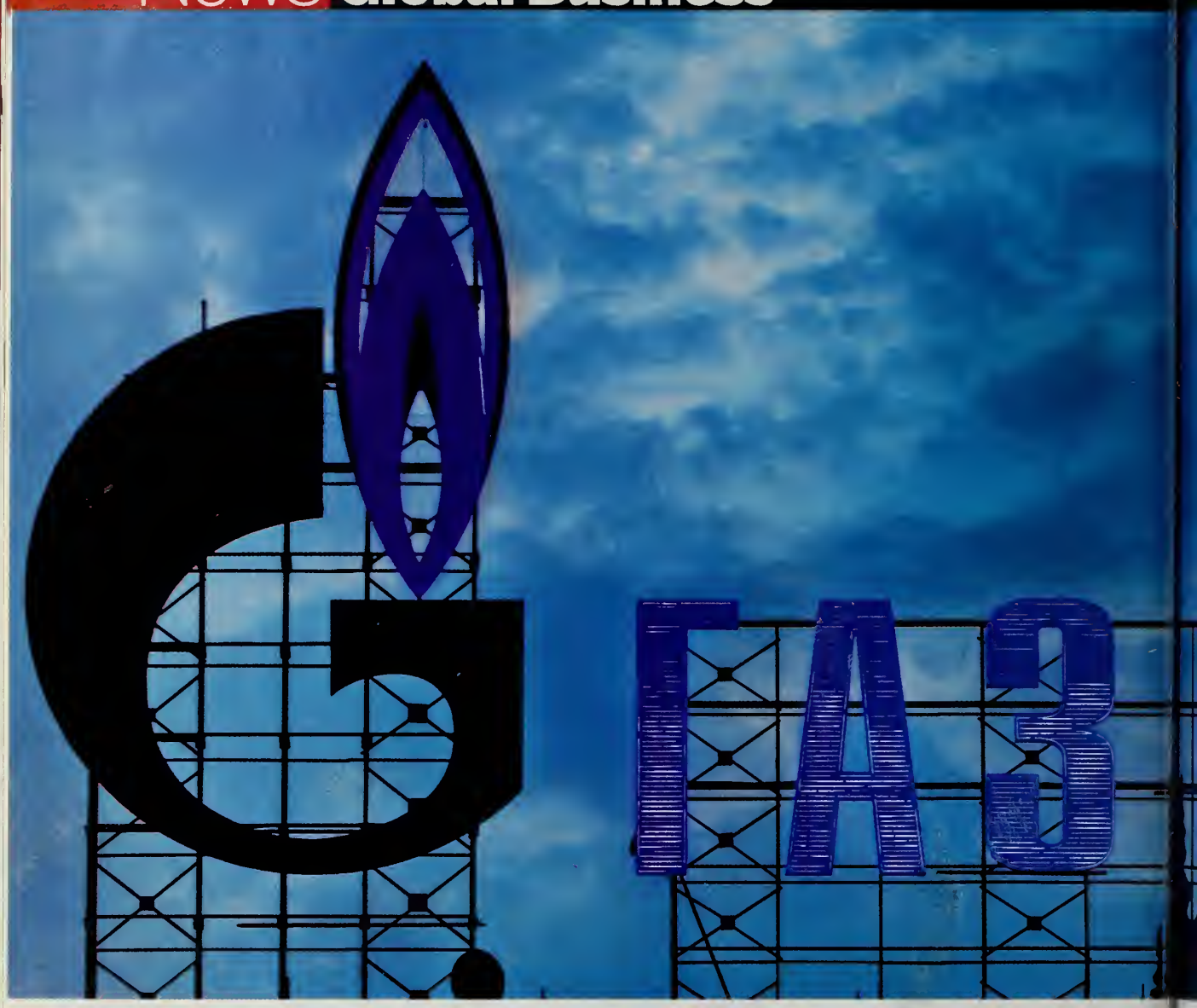


Why Russians Love Gazprom—No Matter What The World Thinks

BY JASON BUSH & ANTHONY BIANCO

AT MIDDAY IN NC Urengoy, the largest in the Nadym-Pur- region of northw Siberia, the streets empty. Nearly every is working in the nea natural gas fields. This windblown post at the edge of the Arctic Circl home to 110,000 people, most of wh are employed by OAO Gazprom, world's largest gas producer. "Outsid can be -40 or -50. We work," says C Paulukov, a laconic southerner v moved to Novy Urengoy 15 years ag the age of 18. "Working for Gazpror considered prestigious." The comp bills itself as the "Pride of the Nation.

The Communist Party's state social dissolved nearly two decades ago, Gazprom's corporate paternalism soft

PUTIN
The President largely runs the conglomerate from the Kremlin

rigors of life in a region the locals re- to simply as "the North." While the rage Russian worker makes $350 a nth, gas field technicians here take me up to $3,000. Roadside billboards claim "Glory to the gas workers!" Na- nwide, Gazprom has 0,000 employees. Workers in Novy Uren- live with their families apartment blocks nted shades of blue, nk, and yellow. zprom covers 97% of cost of running 14 dergartens, charging ployees only 100 bles, or $4, a month for ld care. It provides in- est-free housing loans, e medical care, and vily subsidized over- s vacations.

Gazprom has provoked anxiety in the U.S. and Europe as it has become Russian President Vladimir V. Putin's favorite weapon in a new kind of Cold War, one haunted not by the specter of nuclear annihilation but by fear of going without heat in the winter. Europe's growing dependence on Gazprom has given the Kremlin more leverage over the Continent, from Finland to Germany to Italy. During the recent summit of industrialized nations in St. Petersburg, Russia responded to the continuing impasse on its bid to join the World Trade Organization by delaying the access of U.S. energy companies to a major Gazprom gas project in the Barents Sea.

What most Westerners don't appreciate is that Gazprom's swagger—on display when it temporarily cut gas flow to Ukraine in January and later intimated it might shift resources from Europe to China—reflects more than the company's muscle abroad. The assertiveness also points to Gazprom's ascendency as Russia's preeminent economic institution and as a central player in domestic politics. Putin, who largely runs the company from the Kremlin, relies on Gazprom to solidify his broad popular support, even as he stifles opposition. His subordinates determine which small towns get connected to Gazprom's pipelines and then court voters based on this largesse. Gazprom alone generates 8% of national tax revenue, while the broader energy sector provides the main thrust lifting per capita income in Russia by about 10% a year.

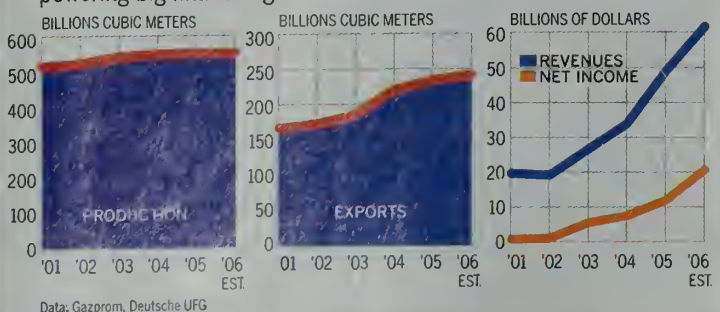
"MY TSAR AND GOD"

IN A CLEARING in the flat, sparsely forested Siberian tundra, a dozen workers from Novy Urengoy manhandle a thick metal pole sunk into the ground. Gazprom and two German companies are investing $1.5 billion to extract the weightless treasure buried here in an untapped subterranean field. If all goes as planned, by 2010 natural gas from this new source will be keeping millions of Germans warm in the cold months. "This is our task, and we'll fulfill it," vows Eduard Khudaynatov, Gazprom's local boss.

The voluble Khudaynatov refers, without apparent irony, to Gazprom Chief Executive Alexei Miller as "my tsar and God." Khudaynatov, 45, embodies at a local level just how intertwined Gazprom and Russian political life have become. He joined the company in 2003 after 20 years

RUSSIA'S GAS BEHEMOTH

Gazprom's production is flat, but steady growth in exports is powering big financial gains



Data: Gazprom, Deutsche UFG

in Nefteyugansk, a center of the oil industry 300 miles to the south, where he became mayor of a municipality. Before taking over a Gazprom subsidiary he also worked for three years as a federal inspector of the northern Nenets region, serving as the Putin regime's eyes and ears.

Novy Urengoy's first buildings went up only 30 years ago, when gas workers arrived from Central Asia and the Caucasus to begin drilling. During the economic anarchy of the Yeltsin era in the 1990s, Khudaynatov explains, Gazprom lost control of key assets, including the untapped field his crews are now readying for production. Putin and Miller have used the Russian courts, as well as tough bargaining tactics, to reassemble the lost holdings—part of Putin's larger effort to consolidate government control over the oil and gas industries.

The North has been generous to Gazprom, which extracted 560 billion cubic meters of gas from the area in 2005. That's 91% of the total produced in Russia and a quarter of all global output. Europe relies on Russia for 26% of its natural gas, a figure expected to rise to 38% by 2020. The company reported net income last year of $11 billion, on revenue of $48.9 billion.

"Gazprom," Khudaynatov says, "is a serious organization with corporate discipline, which today works for the state." The government owns a majority stake in the company, and the two are thoroughly entangled. Khudaynatov's idol, Miller, 44, like many in Gazprom's top ranks, has political ties to Putin from St. Petersburg, President's hometown and power ba Dmitry Medvedev, another member of St. Petersburg clique and chairman Gazprom's board, also serves as Put first Deputy Prime Minister.

Gazprom's political heft would be derscored if, as is rumored in Mosc Putin becomes CEO after stepping do from the presidency in 2008. (Putin denied any such plan.) Medvedev, me while, is widely seen as a leading car date to replace his boss as President in years. Not coincidentally, Medvedev

A Sprawling Empire

To an even greater extent than most other ex-Soviet industrial giants, Gazprom operates in many areas outside its main business

OIL The $13 billion acquisition of oil company Sibneft in 2005 was Russia's largest ever, making Gazprom the country's No. 5 oil producer with 7 billion barrels of reserves

BANKING Gazprombank is Russia's third-largest bank, engaged in everything from investment banking to retail services

MEDIA Owns press and television outlets, including NTV, the only major national channel not wholly state-owned

ELECTRICITY Spent $2 billion to acquire

SCORE The gas giant's football team

been traveling the length and breadth of the country, talking up the benefits his company can bring to towns that still lack gas.

Until recently, Kalyazin, 100 miles th of Moscow, was one such town. Its 00 residents live along the Volga Riv- n Tver Oblast, an agricultural region t is one of the poorest in western Rus-

Dating from the 15th century, yazin has a sleepy, rundown feel, but a ser look reveals that it has enjoyed a d economic rally during the Putin rs. Orders have risen at its shoe facto- ive sewing factories, and a small plant t makes parts for MIG fighter planes. tside of town, opulent new dachas are ng up: getaways for rich Muscovites o are a growing source of local income.

AS WILL CHANGE OUR LIVES"

MMUNIST PARTY apparatchiki drew the first plans for providing gas to yazin in 1950. But nothing much hap- ed until 1991, when Gazprom began lding a pipeline into Kalyazin from a n 50 miles away. Construction crews pped and started over the next 15 rs. While Putin's men have been wide- redited with cleaning up dubious con- cting practices common at Gazprom in 1990s, the company remains ineffi- nt at buying supplies and building elines, according to outside analysts.

When the first gas finally trickled into yazin last Dec. 28, several hundred ple braved the cold to attend an n-air ceremony marking the occasion. ebrants lit a symbolic gas-fired torch side the town's central heating plant. as will change our lives fundamentally l bring us closer to civilization," May- Konstantin Ilyin says.

The theme of "gasification" ripples ough Russian politics. One of the in reasons Kalyazin has gas heat is t in 2004 Tver elected a dynamic new governor, Dmitry Zelenin, a polished ex-businessman who campaigned on the promise of bringing gas to towns without it. As is the custom around the country, he traveled to Moscow, hat in hand, to convince Gazprom CEO Miller that Tver could uphold its end of the gasification bargain to build the smaller pipes that tie local users into a mainline.

By the end of 2006 all nine of Kalyazin's heating plants are to be converted to gas from fuel oil, which sells for about $280 a ton. The equivalent amount of gas—1,000 cubic meters—costs just $93 for industrial users and $56 for residential ones. Consumers will pay just over a dollar each month for gas to power their stoves, compared with $4.50 for bottled propane. Electric bills will decline sharply thanks to the fact that residents will no longer have to use electric water heaters. "I'm proud of it because it's our Russian company," local hotel manager Irina Zhupanova says of Gazprom. "For daily life, of course [gas] is a big plus," says resident Elena Chertovskikh.

With Gazprom board chairman Medvedev maneuvering ahead of the 2008 presidential election, Russia is gasifying furiously. Kalyazin is one of 1,120 towns and villages the company has promised to hook up under its 2005-2007 program. The miracle of gas is to be bestowed on 60% of all Russians, compared with 53% in 2005.

While Gazprom makes headlines for its exploits abroad—45% of the gas consumed in Germany now comes from the Russian giant—the great bulk of Siberian gas always has been burned at home at prices heavily regulated by the state. Long after the Soviet Union was dismantled and the old gas ministry evolved into Gazprom, the Kremlin continued to curry favor with the masses by setting gas prices well below market rates. It wasn't until Putin succeeded Boris Yeltsin in 2000 that Moscow began raising domestic gas rates in hopes of discouraging consumption in those places where gas was available and freeing more of it for export. Prices are still only one-fifth of rates in Western Europe and certainly no spur to conservation.

Gazprom says it loses money on domestic sales, although most outside analysts doubt this claim. What's not in dispute is that the company makes healthy profits selling abroad. Last August the connection between the two markets became evident in an unlikely fashion in out-of-the-way Kalyazin.

In attendance at a large town meeting were not only Gazprom representatives but also Ulrich Hartmann, chairman of the parent of Germany's largest gas supplier, E.ON Ruhrgas, a major Gazprom customer and joint-venture partner. Hartmann's presence in the provincial Russian town signaled Kalyazin's role as a showcase for new energy-saving technologies, which Ruhrgas hopes Gazprom will adopt more generally. "The more Gazprom can economize on gas," Kalyazin Mayor Ilyin explains, "the more gas it will be able to export, including to Ruhrgas and to Germany." ■

—With Jack Ewing in Frankfurt

EUROPE: ADDICTED TO GAZPROM

Data: Standard & Poor's CreditWeek

tional electricity concern UES and 25% w generator Mosenergo in 2004

ULTURE Owns dozens of former state ctive farms via local subsidiaries, one of Russia's largest landowners

ANCE Its Sogaz is Russia's fourth- surance company

C ENERGY Acquired a majority stake roiexport, Russia's sole exporter of ower, in 2004

EERING Acquired a majority of OMZ, one of Russia's largest heavy engineering enterprises, in 2005

PETROCHEMICALS Owns 51% of Sibur, Russia's largest petrochemicals company

AVIATION Its in-house corporate airline, Gazpromavia, is among the largest domestic carriers, with a fleet of 108 aircraft

SPORTS Acquired the Zenit St. Petersburg football club in 2005 and is financing the construction of a new $200 million stadium for it

Data: Gazprom, *BusinessWeek*

BusinessWeek online For more on German dependence on Gazprom and questions about the Russian company's capital investments, go to businessweek.com/extras.

EMERGING
GIANTS

Multinationals from China, India, Brazil, Russia, and even Egypt are coming on strong. They're hungry—and want your customers. They're changing the global game.

BY PETE ENGARDIO

LIKE OTHER RURAL RESIDENTS OF southern Mississippi, Jamie Lucenberg, 35, faced a huge cleanup job last fall in the wake of Hurricane Katrina. He needed a tractor fast to clear debris and trees from his 17-acre family farm, just 16 miles north of devastated Biloxi. "We literally had to cut our way up and down the blacktop roads," recalls Lucenberg.

But rather than buy an American-made John Deere or New Holland, brands he grew up with, Lucenberg chose a shiny red Mahindra 5500 made by India's Mahindra & Mahindra Ltd. "I have been around equipment all my life," says Lucenberg, who also used the tractor to earn extra money clearing destroyed homes along the Gulf Coast. But for $27,000, complete with a front loader, the 54-hp Mahindra "is by far the best for the money. It has more power and heavier steel," Lucenberg says. "When you lock it into four-wheel drive, you can move 3,000 pounds like nothing. That thing's an animal." The local dealership in nearby Saucier, Miss. (population 1,300), figures it has sold 300 Mahindras in the past four months.

Surprised that a company from India is penetrating a U.S. market long dominated by venerable names like Deere & Co.? Then it's

ILLUSTRATION BY DOUG FRASER

IT'S "AN ANIMAL" Lucenberg and his sons are high on their Mahindra

(TOP TO BOTTOM) PHOTOGRAPHS BY PHILIP GOULD; ANAY MANN/PHOTOINK/CONTACT PRESS IMAGES

time to take a look at how globalization has come full circle. A new breed of ambitious multinational is rising on the world scene, presenting both challenges and opportunities for established global players.

These new contenders hail from seemingly unlikely places, developing nations such as Brazil, China, India, Russia, and even Egypt and South Africa. They are shaking up entire industries, from farm equipment and refrigerators to aircraft and telecom services, and changing the rules of global competition.

Unlike Japanese and Korean conglomerates, which benefited from protection and big profits at home before they took on the world, these are mostly companies that have prevailed in brutally competitive domestic markets, where local companies have to duke it out with homegrown rivals and Western multinationals every day. As a result, these emerging champions must make profits at price levels unheard of in the U.S. or Europe. Indian generic drugmakers, for example, often charge customers in their home market as little as 1% to 2% of what people pay in the U.S. Cellular outfits in North Africa, Brazil, and India offer phone service for pennies per minute. Yet these companies often thrive in such tough environments. Egyptian cellular operator Orascom boasts margins of 49%; Mahindra's pretax profit rose 81% last year.

Some already are marquee names. Lenovo Group, the Chinese computer maker, made waves last year by buying IBM's $11 billion PC business. Indian software outfits Infosys, Tata Consultancy Services, and Wipro have revolutionized the $650 billion technology services industry. Johannesburg brewer SABMiller PLC is challenging Anheuser-Busch Cos.' leadership right in the U.S.

These companies are just the first wa
The biggest international cellular p
vider? Soon it may be Mexico's Amé
Móvil, which boasts more than 100 r
lion Latin American subscribers and
BusinessWeek's latest rankings of
world's top information technology co
panies. Never heard of Hong Kon
Techtronic Industries Ltd.? If you buy power tools at Home Depot Inc., where its products now fill the aisles, you probably know some of the brands it manufactures: Ryobi, Milwaukee, and RIDGID. Brazil's Embraer has surged past Canada's Bombardier as the world's No.3 aircraft maker and is winning midsize-jet orders that otherwise would have gone to larger planes by Airbus and Boeing. Western telecom equipment leaders have long looked down on China's

The New Contenders

Boston Consulting Group has identified 100 emerging-market companies that have the potential to reach the top rank of global corporations. From a variety of industries, here are 25 players and their strategies:

AKE BRANDS GLOBAL
Establish primacy at home, expand in neighboring nations, then move to the West.

ARGET A NICHE
Focus on an industry, build scale, and expand globally by acquiring smaller players.

IGINEERING TO INNOVATION
Tap ample low-cost talent at home, then develop innovative products.

VERAGE NATURAL RESOURCES
Take advantage of domestic oil, mineral, or timber resources to attain a cost edge, then go global.

QUIRE OFFSHORE ASSETS
Become a global player by buying oil and mineral reserves or partnering with other veloping-nation companies.

PORT BUSINESS MODEL
Hone a management system, then replicate it globally through acquisitions.

: Boston Consulting Group, company reports, Bloomberg, *BusinessWeek*

COMPANY	COUNTRY	INDUSTRY	REVENUES in billions	STRATEGY color-coded
América Móvil	Mexico	Telecom services	$17.0	
Cemex	Mexico	Building materials	15.3	
China Mobile	China	Telecom services	30.1	
CNOOC	China	Oil and gas	8.7	
CVRD	Brazil	Mining	15.1	
Embraer	Brazil	Aerospace	3.8	
Gazprom	Russia	Oil and gas	48.9	
Haier	China	Home appliances	12.8	
Hisense	China	Electronics, appliances	4.2	
Huawei Technologies	China	Telecom equipment	5.9	
Infosys Technologies	India	IT Services	2.0	
Koc Holding	Turkey	Diversified Industries	18.0	
Lenovo Group	China	Computers, IT components	13.4	
MMC Norilsk Nickel	Russia	Nonferrous metals	7.2	
Mahindra & Mahindra	India	Tractors, Autos	2.9	
Orascom Telecom	Egypt	Telecom Services	3.3	
Petrobras	Brazil	Oil and Gas	56.3	
Ranbaxy Laboratories	India	Pharmaceuticals	1.2	
Sadia	Brazil	Food and beverages	3.6	
Severstal	Russia	Steel	4.9	
Shanghai Baosteel	China	Steel	15.8	
Tata Consultancy Services	India	IT Services	2.8	
Tata Motors	India	Autos	5.8	
Techtronic Industries	Hong Kong/China	Power tools	3.0	
Wipro	India	IT Services	2.3	

uawei Technologies Co. as a mere copier their designs. But last year, Huawei ared $8 billion in new orders, including ntracts from British Telecommunica- ns PLC for its $19 billion program to nsform Britain's telecom network. The al "sent a chill through the rest of the ecom manufacturers," says analyst Michael Howard of Infonetics Research Inc. in Campbell, Calif.

Many more companies are using their bases in the developing world as springboards to build global empires, such as Mexican cement giant Cemex, Indian drugmaker Ranbaxy, and Russia's Lukoil (page 82), which has hundreds of gas stations in New Jersey and Pennsylvania. "What is surprising is the amount of progress emerging-market companies have made in the last few years," says Harold L. Sirkin, senior vice-president at Boston Consulting Group (BCG), which recently published a study based on data collected from 3,000 companies in 12 developing nations. BCG identified 100 emerging multinationals that appear positioned to "radically transform industries and markets around the world." The 100 had a combined $715 billion in revenue in 2005, $145 billion in operating profits, and a half-trillion dollars in assets. They have grown at a 24% annual clip in the past four years. "There is no doubt in my mind that Corporate America has started to take this threat seriously," Sirkin adds.

What makes these upstarts global contenders? Their key advantages are access to some of the world's most dynamic growth markets and immense

ILLUSTRATIONS BY RAY VELLA/BW

CEO Singh's Ranbaxy Labs has 58 generic drugs awaiting U.S. approval by the FDA

EMBRAER, BRAZIL

An Ugly Duckling Finds Its Wings

A half-dozen freshly painted jets fill a mammoth hangar. One, emblazoned with the JetBlue logo, is being fitted with 100 leather seats and individual TV screens as well as 28 miles of electrical wiring. Lined up along the catwalk are planes for Delta Connection, Panama's Copa Airlines, United Express, and Republic Airways. This looks like a Boeing or Airbus assembly plant. But it's actually São José dos Campos, Brazil, home of Embraer, the world's third-largest aircraft maker.

Since 1969, Embraer has been the only company—and Brazil the only country—to make a successful entry into the commercial jet market. More than 1,000 of its planes are flying around the world, including a new generation of 118-seaters that are nibbling at the market served by Boeing Co.'s and Airbus' larger planes. Embraer delivered $446 million in profits on $3.83 billion in revenues last year, and 93% of those sales were outside Brazil.

How did Brazil succeed in such a capital-intensive, high-tech business? Surprisingly, wages, less than one-third of those at Boeing, are not the key factor. First, Embraer tapped into a long tradition of engineering spearheaded by the Brazilian air force's aerospace program created after World War II. For the past six years, Embraer has plowed 6% of revenues into research and development. It trains its newly hired engineers not only in aeronautics but also in market research and finance. Customers call the company's planes well designed, reliable, and cheaper to operate than rival aircraft.

COOL CULTURE Customers like JetBlue sense the pride at Embraer

Second, Brazilians who land jobs at Embraer know they're among the lucky few in a country with a limited number of high-tech positions. Customers sense the pride, says Dave Barger, JetBlue Airways Corp.'s chief operating officer. "If you work at Embraer in Brazil, you're something," he says. "It's a very cool culture. It plugs in nicely to JetBlue." Each time JetBlue takes delivery of a new Embraer aircraft, the airline donates $10,000 to an Embraer program that sends talented, poor students to college. JetBlue has ordered 101 planes, worth $3 billion.

Finally, Embraer has staying power. It grown steadily since the former state-ru company was privatized in 1994. Its high performing, 50-seat regional jets put Embraer on the map, with more than 85 them still flying. And its current wave of

pools of low-cost resources, be they production workers, engineers, land, petroleum, or iron ore. But these aspiring giants are about much more than low cost. The best of the pack are proving as innovative and expertly run as any in the business, astutely absorbing global consumer trends and technologies and getting new products to market faster than their rivals. Techtronic, for example, was the first to sell heavy-duty cordless tools powered by lightweight lithium ion batteries. Jetmaker Embraer's sleek EMB 190, which seats up to 118, has taken smaller commercial aircraft to a new level with a fuselage design that offers the legroom and overhead luggage space of much larger planes. Globalization and the Internet are ushering in this "seismic change" to the competitive landscape, says management guru Ram Cl ran (page 47). Because they can tap same managerial talent, informati and capital as Western companies, "a one from anywhere who sets his minc it can really restructure an industr Charan says. "Make no mistake, t now is a global game."

U.S. corporations, of course, h weathered waves of new rivals befc

success stems from a decision in the late 1990s to invest $1 billion to design a new, larger plane that seats from 70 to 118 passengers for rapidly growing low-cost airlines.

Embraer engineers came up with a new fuselage design it called "double bubble" that allows plenty of head space, legroom, and luggage space, and eliminates the middle seat. More than 40 airlines provided input. That innovation has pushed Embraer ahead of archrival Bombardier of Canada and set the stage for an ambitious move into executive jets. "Years ago our competitors said: 'How dare those ugly ducklings from South America try to sell a jet Northern Hemisphere,'" says Satoshi a, Embraer's executive vice-president gineering and development. nately, they underestimated us."

–By Geri Smith in São José dos Campos, Brazil

e 1960s and '70s saw the rise of estern European industrial groups ch as Unilever, Philips, Siemens, and lkswagen. Then came Japanese gi- ts such as Sony and Toyota, followed South Korean powerhouses such as undai and Samsung and Taiwanese ctronics conglomerates in the '90s. ch time, chief executives found emselves caught off guard. The best U.S. corporations adapted and emerged stronger than before.

Yet this new group of game-changing companies is different on many levels. For starters, the new players are coming from many nations at once and deploying an array of strategies. They're also arriving from lands that, while growing fast, remain relatively poor. Germany and Japan were industrial powers before World War II and built on those strengths to reemerge as global heavyweights. By contrast, China and India have begun to emerge from extreme poverty only in recent decades. Per capita income in China is still just $1,300 a year. In India it's $620. That sounds like a huge handicap for companies from those nations: It implies low-income customers, meager capital, and hand-me-down technologies. It also means struggling with arcane regulations, corruption, and poor infrastructure.

Fit Survivors

HARDSCRABBLE ORIGINS, though, can be a vital source of strength. These companies have learned to make money by developing reliable, easy-to-use goods and services at very low prices. And those skills have equipped them well for operating elsewhere in the Third World. Telcos such as Orascom and India's Bharti Telecom, for example, earn high margins while selling cellular service in some nations for 2¢ or 3¢ a minute, while América Móvil pioneered the use of pay-as-you-go cellular service that allows the masses to pay as little as $4.50 for a prepaid card. India has some of the lowest pharmaceutical prices in the world. The country has 101 brands of generic ciprofloxacin, used to treat bacterial infections such as pneumonia and anthrax, costing an average of 63¢ for 10 tablets of 500mg each. That compares with $51 for generic ciprofloxacin in the U.S., according to Ranbaxy Laboratories. "By learning to compete in this environment, we have gained strength in development and marketing that helps us around the world," says Ranbaxy CEO Malvinder Mohan Singh.

The late 1990s proved to be a time of key opportunity for these companies. In the wake of financial crises in Asia, Latin America, and Russia, many Western companies and banks pulled back from all but a few developing nations. Well-run local players bought assets from retreating Westerners on the cheap and doggedly pursued opportunities from Nigeria to Pakistan to Colombia. From 1995 to 2003, the World Bank estimates, corporate investment from one developing nation to another more than tripled, to $47 billion annually. It probably has neared $60 billion since.

That leaves the new multinationals in a strong position. Over the next decade, the World Bank projects, developing nations' share of world gross domestic product is expected to grow from one-fifth to one-third. During the next two

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The Story Behind the Story For a podcast interview with Senior Writer Pete Engardio by Executive Editor John A. Byrne, go to **businessweek.com/search/podcasting.htm**

100 New Players to Watch Boston Consulting Group's list of emerging market companies most likely to make a global splash.

A Brazilian Mission How Embraer and JetBlue are working together to boost poor students' educational chances.

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Sun microsystems share

POWER SURGE Milwaukee Electric tools from Techtronic

TECHTRONIC INDUSTRIES, HONG KONG

'We Have the Vision To Be No. 1'

Five years ago, Ryobi's limited offering of cordless drills accounted for a tiny piece of the U.S. market. Now, Ryobi Ltd. boasts one of the broadest and best-selling product lines at Home Depot Inc. In three years, sales of power tools bearing Emerson Electric Co.'s RIDGID brand have tripled. Last year, Milwaukee Electric Tool Corp. helped revolutionize its industry by being among the first companies to introduce cordless tools that use light, long-lasting, rechargeable lithium ion batteries.

The common element in all these successes is Techtronic Industries Co. The Hong Kong company illustrates how far a determined challenger can go by targeting a narrow industry segment—and then seeking to dominate. By leveraging a huge manufacturing and engineering base in China to drive down costs and speed innovation, it now is shifting into overdrive through acquisitions. Since 2000, Techtronic's sales have surged fivefold, to $3 billion. In that time, its share of the $6 billion U.S. electric power tool market has grown from less than 5% to more than 20%, says market research firm Freedonia Group Inc. Black & Decker Corp. still holds a commanding 30% share, but Techtronic is thinking big. "We have the vision to be No. 1, and we believe we can do it," says Chairman Horst J. Pudwill, a former Volkswagen executive.

Pudwill co-founded the company in 1985 as a maker of rechargeable battery packs for cordless tools. It then made tools for do-it-yourselfers on a contract basis for Sears Holdings Corp.'s Craftsman brand, among others. Then it bought control of brands, including rights to the Ryobi name outside Japan, Royal vacuum cleaners, and Homelite garden tools. The big move was the $626 million purchase of Milwaukee Electric Tool and Germany's AEG Power Tools—both premier brands used by professionals—from Atlas Copco.

More important, though, is what Techtronic has done with those brands. By shifting most production to its massive factories in South China, where it has 16,000 workers and engineers, it constantly cuts costs while loading its products with new features. Techtronic can also take new tools from the conceptual stage to production in as little as six months, thanks to 24/7 collaboration among designers in Asia and Techtronic's "concept centers" in Hong Kong, South Carolina, Germany, and Britain. That allows the company to expand its product lines dramatically.

Ryobi, aimed at do-it-yourself hobbyists, is a good example of how Techtronic can transform a brand. In 2004 it teamed up with Home Depot to launch the hugely popular "one plus" system, which lets 30 different cordless tools, from drills to fans, run off the same rechargeable battery. A Ryobi kit with an 18-volt drill, circular saw, reciprocating saw, flashlight, vacuum, and two batteries retails for just $169. Techtronic figures the innovation helped sell 25 million Ryobi tools in three years. The company "brought innovation and freshness at a time when the tool industry really needed it," says Craig Menear, Home Depot's senior vice-president for merchandising. "We've seen the competition really step up, and that's healthy." That may be the clearest sign that a game-changing multinational is on the way.

–By Pete Engardio in Hong Kong

decades, predicts Goldman, Sachs & Co., China, India, Brazil, and Russia alone will add to their populations some 225 million consumers who earn at least $15,000 a year. That's more than the combined population of Germany and Japan. Of 1.2 billion new cellular-phone subscribers worldwide by 2010, estimates Pyramid Research in Cambridge, Mass., 86% will be in developing nations. Chicago economic consultant Keystone India figures emerging markets will make up 69% of all new car sales by 2030, compared with 26% now.

Where they choose to fight, of course, the established multinationals still hold big advantages over the upstarts. Citibank, General Electric, Honda, HSBC, Motorola, Nokia, and Philips are masters at using low-cost manufacturing, engineering, and managerial talent from Bangalore to São Paulo. Few developing-nation companies have such management agility.

That's especially true in China, wh promising consumer-electronics mal such as Bird, Konka, and TLC h stumbled because of overcapacity home and poorly managed acquisiti abroad. "Everyone sees Chinese en prises as a threat, but in fact they fa lot of difficulties going global," conce Zhang Xuebin, CEO of $1.5 billion c TV maker Skyworth Digital Holding

The best emerging multinatior though, have amassed piles of cash, h

t global research and development vorks, and boast world-class man- nent. You get the idea how far some panies have come by touring Em- r's campus in São José dos Campos, size of 55 soccer fields. On the floor of hangar, dozens of workers in impec- e overalls put the finishing touches hree luxurious Legacy 600 corporate that seat up to 16. In a classroom hed above the assembly line, 30 en- ers enrolled in the company's grad- aerospace program fine-tune a erPoint presentation on a hypotheti- new jet they have designed after con- ting exhaustive market research and -feasibility studies.

ocal Heroes

HER EMERGING players are using r access to deep pools of low-cost lo- engineers and experience gained in eloping nations to close the with Western incumbents. Just e years ago, Huawei was wn in the U.S. mainly as the ipany that Cisco Systems Inc. ght copying its designs. But awei, which spent $558 million R&D last year and employs 0 engineers at its sprawling nzhen campus, is winning re- ct globally. Last year 57% of its s were outside China. It boasts % market share in Asia and 9% Latin America, cutting sharply Cisco's lead in those regions. awei is the global leader in the idly growing equipment market for ce-over-Internet protocol service. Besides undercutting Western rivals' es by 20% to 50%, Huawei is adept at igning equipment appropriate for de- ping nations. "A Cisco always starts a cussion with its software superiority," s Steven Davidson, leader of strategic nge at IBM in Asia. "But many com- nies in developing nations would ner pay half the price for software that s the job done."

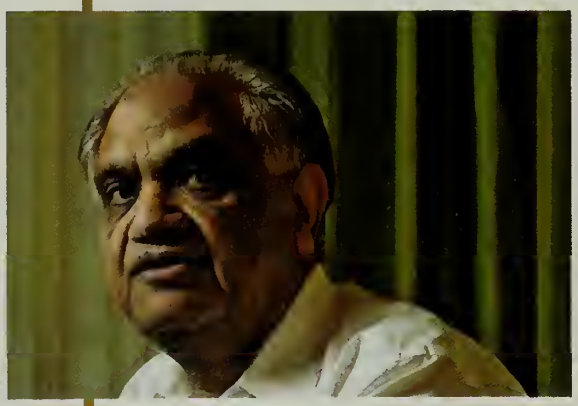
A raft of Indian companies also have ten in position for a U.S. assault after lding heft at the margins of the global nomy. Ranbaxy may rank just No. 14 the $28 billion U.S. market for pre- iption generic drugs. But it is a leader nations like Nigeria and Brazil. It has ned goodwill by being one of the gest suppliers of $1-a-day generic S treatments to Africa at cost, and es to have its own new malaria drug the market by 2008. It has also

Why It's a Small World After All

BY RAM CHARAN

Radical change in the structure of the world economy is rare. But make no mistake: The emergence of world-class companies from developing nations is a shift that portends a new global game.

Indeed, emerging economies are no longer just about outsourcing or tapping into local markets. We are seeing the first wave of emerging-nation players that have clear advantages in their industries. Rather than the competition among three or four countries that long dominated global commerce, we have entered an evolving game of multiple geographies. The importance of that change—and the challenge it poses to the dominance of the West and Japan—cannot be overstated.



CHARAN The Net brings mobility of knowledge

This seismic shift began roughly 10 years ago, brought about by three forces: mobility of talent, mobility of capital, and mobility of knowledge, thanks largely to the Internet. As a result, anyone from anywhere with determination can restructure a global industry. Lakshmi N. Mittal used knowhow from his family's steel business in India to build London-based Mittal Steel Co., the world's largest. Mexico's Cemex is a new world leader blossoming far from traditional business centers like New York and Tokyo. If India's Tata Motors can develop a $2,000 car, it will become yet another.

The rise of these multinationals shouldn't be surprising in this age of globalism. But what few realize is that the advantages of such developing giants amount to more than cheap labor and low currencies. (Even companies that are lucky in those respects can have productivity and quality problems.) Instead, their leaders are good executors who see niches in the global economy and can tap world intellectual capital and financial markets to consolidate control across their industries.

Many of these companies are headed by entrepreneurs who were trained in the West and who know how to attract top talent from America and elsewhere. Wipro of India recruited Vivek Paul from General Electric Co., and he helped build Wipro into a highly profitable, global information technology powerhouse. Shanghai Automotive Co. recently hired Philip Murtaugh, who used to run the China office for its joint-venture partner, General Motors Corp. And Haier Group Co., China's $12 billion consumer-electronics leader, has given Mike Jemal, its U.S. president and a former New York electronics retailer, free rein to pursue markets where Haier wants to be at least No. 2 or 3—not just on cost but by embracing an almost manic customer focus to fulfill unmet needs.

First World businesses must recognize that top intellectual capital is available to local entrepreneurs in emerging nations, and they should expect intense competition from these newcomers at home and abroad. But such nascent competitors have another potent advantage: a lack of legacy costs that keep even the most savvy Western outfits from fully realizing the efficiencies of their size and market power. That's one reason budding multinationals will not be a passing fad. Ready or not, the globe is about to get a lot smaller.

Ram Charan is a leading U.S. management consultant and co-author of two business best-sellers.

PLAYBOOK: BEST-PRACTICE IDEAS

Fighting Back

Here are some options U.S. companies have in responding to the emerging multinational threat

KNOW YOUR CHALLENGERS

Emerging multinationals may have unorthodox business models, but they could be more innovative and effective than you think. Analyze their advantages and anticipate how they may transform your industry.

COMPETE HEAD-ON

Letting a future global rival build share, scale, and handsome profits uncontested at home could backfire in the long run. Attacking it at home by boosting R&D or allying with its rivals can blunt the offensive.

TAP THEIR RESOURCES

Incumbents can often neutralize an emerging challenger's low-cost advantages. Many multinationals make better use of Chinese and Indian engineers, factories, and suppliers than companies based in those nations.

JOIN 'EM

Leading companies in developing nations can be great partners. They know the terrain and real market needs at home and in other key emerging growth markets. By collaborating on product development, you can leverage their low-cost resources.

KNOW WHEN TO FOLD

Sometimes keeping up a battle isn't worth the time and money. If an emerging rival has a clear advantage in a segment, it's time to exit. Or you can form a joint venture and still profi by licensing intellectual property or selling services

Data: Boston Consulting Group, *Business*

snapped up smaller generic drugmakers in Belgium, Italy, and Romania. When Ranbaxy first began to market its drugs in Europe, recalls CEO Singh, its sales staff was often kept waiting hours before skeptical purchasing managers would hear their pitch. Now, Ranbaxy is a top supplier in much of Europe, and 80% of its $1.2 billion in revenues comes from overseas. It has staff in 49 nations, plants in seven, and an R&D team of 1,100 at its 17-acre campus outside New Delhi.

Ranbaxy hopes this R&D base will enable it to vault into the top five in the U.S. by 2012 and to No. 1 globally, passing Israel's Teva Pharmaceutical Industries Ltd. It has 58 generic medicines pending U.S. Food & Drug Administration approval, including a version of the a cholesterol drug Lipitor. Ranba pipeline is the second-biggest in generic industry.

How can Western multinationals spond? The first step is to begin respect the new competition. That is the attit David C. Everitt, president of Dee $10.5 billion agricultural division,

HAIER, CHINA

Taking a Brand Name Higher

It's "High-er," explains Michael Jemal, for what one assumes is the umpteenth time. "As in higher and higher." To Jemal, president of giant Chinese appliance maker Haier Group's American operations, the pronunciation is vital. In China as well as the U.S., Haier tends to come out more like "hair." And studies show most Americans associate Chinese brands with shoddy quality.

That's a perception Jemal is fighting mightily in his bid to make Haier the next premier name in white goods. Haier follows a playbook borrowed from the Japanese and Koreans: First, build a huge base at home that gives you economy of scale and a market where you can test products and perfect your manufacturing. Then go on the offensive overseas and race up the value chain.

Thanks largely to its leadership in China, Haier is the world's fourth-largest home appliance maker, with 2005 sales of $12.8 billion. Since entering the U.S. in 1999, it has become the top-selling brand of compact refrigerators, a market leader in home wine coolers, and No. 3 in freezers. U.S. sales last year: $750 million. But Haier is still known in the U.S. mainly for commodity goods. "When I look across the major appliance categories, I've not yet seen [Haier] have any perceivable position," sniffs David L. Swift, Whirlpool Corp.'s boss for North America.

NEW FRIDGE In the U.S., Haier is selling a broader range of products

(BOTTOM) MARK PETERSON/REDUX

To change that, Haier is unveiling a line of eco-friendly, tech-rich appliances priced at $600 to $1,500, compared with the $200-to-$300 range it's known for. There's the Genesis top-loading washing machine, starting at around $725, and a dishwasher with food particle sensors to determine when plates are clean. "They won't be able to transform their image quickly, but it can be done," says Bob Walsh, chief operating officer of Fairfield (N.J.) Karl's Sales & Service, which stocks the Genesis washer.

Sharp competition in China has sliced into Haier's margins. But there's still reason to think the company has a shot. It has 50,000 workers in 46 factories, including a plant in Camden, S.C., and a massive complex in the coastal city of Qingdao, turning out more than 43 million products, from full-size fridges to digital TVs. This base gives Haier the heft to get new products to market quickly to fill any niche. "We used all our resources to get into the market at the low end, then we creeped into the midrange," says Jemal. "Now we are entering a new strategic phase."

–By Pete Engardio in New York with Michael Arndt in Chicago

pting toward Mahindra. Everitt cedes the Indian rival could some- pass Deere in global unit sales. ıindra dominates the Indian mar- which is bigger even than Ameri-, and is especially strong in the ll tractors that account for two- ds of U.S. sales. But Deere also is ding up its game by, among other ıgs, boosting R&D in higher-end tors for mega-farms in the U.S., ope, and Brazil, and expanding its ı production in India and else- re. "We are not afraid of competi-," Everitt says. "It gets the juices ıg and helps us find ways to be better."

tanding Pat

OTHER STRATEGY is to refuse to cede und either at home or abroad. Last r, Whirlpool Corp. agreed to pay a prisingly high $2.8 billion to buy ytag Corp. It wanted to keep Maytag of the hands of China's Haier, which mping up in the U.S. and had made a l bid. Cisco, meanwhile, is keeping the pressure in China, Huawei's home rket. Cisco continues to win large or- s from Chinese corporations, has wed $650 million into Chinese tech tups, and has forged a tieup with lo- Huawei rival ZTE Corp.

Then there's always the strategy of ling the new challengers. Nortel Net- rks Ltd. and 3Com have formed tele- n equipment and design ventures h Huawei. And Navistar Internation- Corp. in Warrenville, Ill., has a joint ture with Mahindra to build trucks l buses for export. "These companies be opportunities," says BCG's Sirkin, you can work with them."

No matter how the big U.S. compa- s respond, gone is the era when they ld afford to wait for an emerging rket to ripen, then count on their abil- to roll over the unsophisticated local yers. "If you don't participate in these rkets, you not only miss opportuni- but also are cut out of all the innova- n that comes from competing there," s University of Michigan manage- nt strategist C.K. Prahalad. "Then ı won't be able to withstand the pres- e when these companies come and you here." Whether one chooses to ıfront or collaborate, the new multi- ionals are set to change the rules in lustry after industry.

–With Michael Arndt in Chicago and Geri Smith in São José dos Campos, Brazil

A Djezzy phone store in Algeria

ORASCOM TELECOM, EGYPT

This Mobile Upstart Really Gets Around

Last year, Naguib Sawiris, chairman of Cairo's Orascom Telecom Holdings, added Italian operator Wind Telecomunicazioni to his growing mobile telecom empire for $15 billion. Believing the company was "a mess from a management point of view," he quickly dispatched a team of five trusted Middle Easterners, including new chiefs of fixed line, purchasing, and technology, to straighten things out. He says they're doing a bang-up job. Wind now expects double-digit revenue and profit growth in an otherwise stagnant market. The people Sawiris sent to Italy, he says, are "10 times better than" the former management of Wind.

Sawiris is a great advocate of operating in and from emerging markets. While he has had near-disasters, such as getting financially overextended in 2003, it's hard to argue with his success so far. Starting from scratch in 1997, he has strung together a telecom empire that stretches from North Africa to Iraq to Pakistan and Bangladesh. At the end of the first quarter of 2006, Orascom subsidiaries had a total of 35 million subscribers, a 101% year-on-year increase. For 2005, total revenues were $3.2 billion, a 64% year-on-year gain, while profit before tax rose 56%, to $857 million.

In an interview in his French art deco office at the top of his family's tower on the Nile, Sawiris ticks off the advantages that emerging markets give him over established European rivals. While capital costs are similar around the world, operating expenses are perhaps a tenth in Egypt or Pakistan of what they are in Britain or France, he estimates, because engineers and salespeople work so cheaply. But the killer edge is growth. Sawiris' operations are adding subscribers at the rate of over 100% a year. "Sawiris can use scale to keep cutting costs," notes Wael Ziada, an analyst at EFG-Hermes Holding Co., a Cairo investment bank.

Sawiris hires the best people for top jobs, regardless of nationality, and motivates them with generous stock options. Operating a family-controlled but publicly listed company from Cairo allows him freedom to make decisions others would consider risky. In 2001 he bid what many observers thought was a too-pricey $737 million for an Algerian license, topping France Telecom. But Djezzy, as the Algerian company is now known, has become his empire's crown jewel. When he needed financing help, he brought in investment funds controlled by none other than the late Yassir Arafat.

While he imports technology from the West, Sawiris believes in local branding. Names such as MobiNil in Egypt and Djezzy in Algeria have a homegrown flavor. His marketers are also masters at tailoring offerings to local pocketbooks. "We don't need to go out and import a brand like Vodafone," he says. Of course, Western telcos such as Vodafone Group PLC are seeking quarry in emerging markets. "They are too late," Sawiris says.

–By Stanley Reed in Cairo

Stil

The Phone Companies Don't Get It

MARK GIMEIN

They block competition and charge too much.

You call this a communications revolution?

ONE DAY THIS SPRING in San Antonio, I sat on a couch to watch TV with two AT&T executives and three public-relations aides. It's not a bad job, sitting on a fortable sofa in a pretty, air-condi-ed brick Tudor watching TV, and the I got it was by telling AT&T's PR s that I was working on a story that d wind up saying that in this age of rmous technological upheaval, their own behemoth was not adding to ovation but standing in its way. No, they said, that's all wrong. If only I d go down and see AT&T's new video nology in action. Some 200 participants in AT&T's test there e the first beneficiaries of the great new network war, the a-telcos' drive into video. Come down to San Antonio, they , we'll take you to a customer's house to show you.

he day before my trip to Texas, on my way back from a tour T&T's Florham Park (N.J.) labs, a PR guy had clarified that didn't mean just any home. "Hundreds of reporters have d to see this," he said, and they couldn't ask their test cus-ers to take them all in. So the customer probably would be, le not an AT&T employee, someone with some connection to company. "A friendly," the PR person had said.

When I get to Texas, however, still another PR person con-s to me that, despite the many press requests, I will be only second reporter to see the new video offering in action. You ld think rounding up a bona fide customer for two re-ters shouldn't be impossible, but the proud homeowner who ets me at the door is wearing brightly polished cap-toed ox-ls and a blue button-down shirt, an odd outfit for a guy sit-around his own house waiting for a reporter to stop by. so we make our greetings and I sit down in front of the TV. he armchair next to me Jeff Weber, the AT&T vice-president charge of Project Lightspeed, grabs the remote control. presses a button. The channel changes (much faster, he points out, than on a conventional cable system). He hits another button. It changes again.

He gives a little flourish and gestures to the set. "TV," he says. "It works."

I ask if this brand-new system will let me record one show while watching another, as TiVo or my own cable box at home do. Sure, says Weber, as soon as AT&T gets the new generation of set-top boxes built and delivered.

Meanwhile, the homeowner has remained standing, watching me watch TV. So I try to break the ice, asking what he does, assuming he doesn't work for AT&T. Actually, he corrects me, he does.

"So what exactly do you do?" I ask.

"I'm the architect of Project Lightspeed." For a few seconds I take this in, wondering why nobody bothered to tell me.

Baby Steps

IT'S A CLASSIC MOMENT, an illustration of where the power lies in telecom. It is tough—no, make that impossible—to think of another ostensibly technology-focused industry where the chief technical architect of a planned multibillion-dollar, company-changing project does not merit so much as an introduction. In fact, in San Antonio, that architect, John Kirby, neatly managed to dispel any confusion about the status of engineering at the company when, after clarifying what it is he does, he explained that when it came to big new projects, "marketing dreams it up, and then I have to design it."

Ah. Welcome to Telco Land, a strange country where the biggest players talk more and more about innovation yet approach new ideas with baby steps, build little themselves, and when they think about technology are apt to believe it's a threat they have to fight.

In case you haven't been keeping score, after the original phone company, American Telephone & Telegraph, was broken up in 1984, the country was left with eight major regional tel-

cos. Over the past decade these companies proceeded to gobble one another up. Now there are four: AT&T, Verizon, BellSouth, and Qwest. Just keeping track of the mergers and names is an endless challenge: The "new" AT&T is actually the rechristened SBC, based in Austin, Tex., which acquired the venerable name last year—and it's in the process of buying BellSouth. That will leave two phone giants, Verizon and AT&T, and the much smaller Qwest. The biggest wireless carriers are Verizon Wireless, majority owned by Verizon, and Cingular, which is soon to be wholly owned by AT&T. It's not exactly the return of the old Ma Bell monopoly—the world has gotten way too complicated for that—but that's a lot of power in the hands of just two companies.

One way in which these companies are very different from the old phone monopoly is that while the original AT&T had a world-class research operation, its successors don't. One of the signal facts of the communications revolution is that virtually all the new technologies that made it possible were developed outside the phone world. Last year, Verizon's revenue came in at nearly $80 billion. AT&T (without BellSouth or Cingular) had revenue of $44 billion. And yet while Intel Corp. spent $5.1 billion last year on research and development, AT&T spent just $130 million. The word "research" doesn't even appear in Verizon's annual report.

But if in the era of telecom deregulation the most common industry buzzword was "competition," it is now "innovation." And Verizon and AT&T increasingly are asking to be viewed as leaders in the realm of ideas. Do a Web search on "Verizon" and "innovation" and you'll pull up speeches by Verizon CEO Ivan G. Seidenberg extolling its importance. The phone giants have even used "innovation" as a key justification for their aggressive merger wave. Last year, when SBC was buying the remnants of AT&T, SBC Chief Executive Edward E. Whitacre made sure to note that by merging, the combined company would have "the intellectual and financial resources to spur innovation."

"We are the insurgents who are trying to come in and change the marketplace," says a Verizon lobbyist

Verizon and A
are under great p
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They lag behind the
ble companies in t
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monopolies are u
attack as those same
ble companies' offe
provide phone servi
lower rates along
TV and data. Loo
ahead, wireless t
nologies ranging f
the familiar Wi-F
more powerful wireless standards being advan
by researchers in academia and companies suc
Intel pose a whole new set of threats.

In response, AT&T and Verizon are rushin
build networks to deliver TV service and h
speed broadband access. They point to ther
make the case that, yes, they are technology c
panies. Verizon is spending billions to roll c
next-generation phone, data, and video netv
called FiOS (as in "fiber optic") to give its
tomers faster Internet service and an alterna
to cable. While not matching FiOS' impres
speeds, AT&T promises to do something similar with Li
speed, which it started marketing in parts of San Antonio u
the brand name "U-verse" not long after my visit.

The rhetoric of the tech biz has always been about who
out-revolutionize whose revolution, and executives at AT&T
Verizon are embracing it. Says Thomas J. Tauke, a former I
congressman who is now Verizon's chief Washington lobb
"As we deploy new technology, what is happening is tha
are the insurgents who are trying to come in and change
marketplace."

To give Verizon its due, the company has made some m
strides. Its FiOS broadband and video network is by mos
counts the state of the art in network technology. (It's pr
though—the highest level of
home broadband service
$109 to $139 a month.)

But dissonant realities ren
Isn't it a little odd, for exampl
hear the CEO of a company the
of AT&T talk about needing t
bigger to have the resources t
novate? In fact, over the
decade the big telcos have m
looked outside for technologic
novation. "We develop serv
and we figure out how to use
deploy technology that many
ers are developing," says Veriz
Tauke. Edmond J. Thomas,
ran the labs at Verizon when it
Bell Atlantic, puts it another
"They do very little fundam
research and very little adva
development," he says. "Their

Things Could Be So Much Better

WHAT'S TECHNICALLY POSSIBLE	WHAT THE TELCOS HAVE IN MIND
■ More powerful Wi-Fi-like networks on lower frequencies, open to anyone with a transmitter	■ Expensive 3G data services on networks owned by the phone companies
■ High-speed data access, open to any new service	■ High-speed data access that providers of new video services will pay the phone companies to use
■ Cell phones that can interact wirelessly with your computer to send pictures, address books, or files	■ Phones with crippled features that send data only over the carriers' own networks
■ Cheap, ubiquitous wireless access in places with citywide networks	■ Service to the home from cable and telcos, and wireless service at Starbucks and the like
■ TV programming from telcos that competes with cable	■ TV programming from telcos that competes with cable (yes, they have this one right)

ıe world is: 'We can buy it
where.'"
here is something to be said
buying it elsewhere." If the
telcos built everything
nselves, there would be no
o and no Motorola. But
s of buying it elsewhere has
led a culture distrustful of
nology—and of progress:
impossible to imagine Mi-
oft developing a big new
luct and having the lead en-
er shift from foot to foot in
corner pretending to be just
her customer. It has meant,
ith AT&T's Lightspeed, that
s are likely to offer services
only match, but not surpass,
e available from others. And
easingly their approach has
the telcos on the wrong side
technological innovation,
ing them in the position of
ecting their investments in
r networks from the en-
chments of new ideas.
o some extent, Verizon and
T have been forced to take
ovation seriously and move
offering TV and improved
dband. A world in which
telcos competed with big
e companies was something
isioned as far back as the
6 Telecom Act. It only be-
e a reality when Internet-based phone services allowed ca-
companies to offer the dreaded "triple play" of television,
dband, and phone, putting AT&T and Verizon on the de-
sive. But even as they've pushed into this new area, in others
telcos' instinctual response has also been to fight new tech-
ogies rather than foster them.

Tech companies worry that the telcos will try to extract greater tolls for the use of their networks

Throwing Sand in the Gears

AT'S WHAT HAPPENED in the skirmish over "municipal
i"—the effort by cities such as San Francisco and Philadel-
a to offer citywide wireless services that AT&T and Verizon
ght (a struggle Verizon has largely abandoned but AT&T is
pursuing). It's evident in battles that are just starting on
itol Hill over emerging technologies, such as a proposal to
n the empty space between TV channels to powerful WiFi-
services that would pose a serious threat to the telcos' $60-
80-a-month wireless broadband businesses. And you can
it in less technologically sexy areas as well: Verizon crippling
tures on its phones that would let users send photos or
es to and from their computers without paying Verizon, or
T's yearlong foot-dragging in giving Internet phone com-
tor Vonage access to its 911 switches.
But fighting innovation is just a stopgap. The giant telcos
e been in the driver's seat when it comes to communications
nologies because of their sheer size. "Our motto," says CEO
l E. Jacobs of Qualcomm Inc., which develops many of the
s and technologies that make cell phones work, "is love the carriers. We know which side our bread is buttered on." Increasingly, though, the telcos are not the only game in town. And with competition gearing up, getting serious about innovation increasingly becomes a necessity, not just words.

Will the telcos use their positions to bring more new ideas to consumers? For years technologists have talked about the possibilities opened up by combining television and high-speed Internet. But neither Verizon nor AT&T take advantage of that. Talk to them about what's next, and both companies bring up the possibility of providing weather and sports scores in a box on the TV screen. Not exactly radical. But it's what you'd expect from companies that are afraid of new technology.

That paucity of new ideas has led critics to think the telcos see their future not in developing better services but in extracting greater and greater tolls from anyone who wants to use their networks. Over the last few months AT&T in particular has managed to scare the heck out of technology companies by talking about charging Internet content providers such as Google Inc. or YouTube for access to the customers on its new network. That's a logical plan for a company like AT&T, but it's probably not one that can be sustained forever.

There's another strategy the telcos could consider. In San Antonio, AT&T tried very hard to sell me on the virtues of Project Lightspeed. But the most impressive thing you're likely to see in AT&T's labs might be a feature of Homezone. Lightspeed's less ballyhooed sibling, Homezone is a simpler video and Internet system that combines satellite TV with a DSL line. One feature of the set-top box AT&T has developed for Homezone is the ability to get music files easily from a PC and play them on a television or home entertainment system. It was the one time during my visit that I thought: "Wow, I'd like to have this at home." Homezone demands no expensive new network infrastructure and no partnership in which companies pay AT&T for exclusive access. It's proof that a simple new idea can grow inside a giant telco. It's a hint of what AT&T might achieve if it spent on research and development even half of what a company like Intel does. But it may not be a hint the telcos are ready to take.

Dial into the Debate

Big Idea Read more about the push to open up unused spectrum between TV channels to deliver powerful new wireless services

Verizon's View In a Q&A, its Washington lobbyist begs to differ

BusinessWeek online
businessweek.com/extras

When Outsourcing Turns Outrageous

Contractors may be saving the Army money. But fraud changes the equation

BY DAWN KOPECKI

THE U.S. MILITARY HAS lost billions to fraud and mismanagement by private contractors in Iraq who do everything from cooking soldiers' meals to building hospitals to providing security. That raises a question: Does Pentagon outsourcing make sense?

"The presumption is that it is cheaper," says Jerrold T. Lundquist, director of the defense and aerospace practice at the consulting firm McKinsey & Co. Competitive bidding can keep the price of services down. Contractors are, in theory, more nimble at mobilizing and paring back their forces than a huge military bureaucracy. A recent study by the nonpartisan Congressional Budget Office concluded that in 2004 the U.S. reduced its costs by one-third for feeding and housing troops by paying one contractor to do the work—a savings of nearly $3 billion. Such findings point to the conclusion that even with a lot of fraud and waste, outsourcing may still pay off.

> Rules requiring competitive bidding were waived

But some experts on the topic aren't convinced. Because no one has an authoritative overall estimate of how much has been lost in Iraq to contractor deceit and incompetence, and many investigations are just getting under way, the financial harm could in the end outstrip any savings. There's also the intangible cost of taxpayers seeing their money wasted or stolen rather than spent to support troops risking their lives and dying. "What has happened in Iraq is just disgraceful," says Jeffrey H. Smith, a former Central Intelligence Agency general counsel during the Clinton Administration who now represents military contractors in private law practice.

Instances of military outsourcing gone bad in Iraq are now legion. For example, Parsons Global Services Inc. of Pasadena, Calif., lost its contract to build 150 health centers after it completed just six centers and collected $190 million—$30 million over the project's budget. The U.S. Special Inspector General for Iraq Reconstruction is now reviewing all of Parsons' Iraq work. Officials at Parsons, which eventually completed an additional 13 centers, stand by their work, saying employees performed well under "extremely volatile conditions."

It's difficult to put an accurate price tag on contractor fraud in Iraq, however. The Government Accountability Office, the investigative arm of Congress, reported earlier this month that the Defense Dept. has recovered about $2 billion since 2001 from all outside contractors and government procurement officials accused of dishonesty or mismanagement, but the GAO didn't isolate those working in Iraq.

BILLIONS UNDER SCRUTINY

THE LOSSES TO fraud and waste in Iraq are almost certainly in the billions, current and former government officials agree. The Special IG for Iraq Reconstruction says it has more than 80 open investigations and has referred 20 more cases to the Justice Dept. for prosecution. A spokesman for the criminal investigative arm of the Defense Dept. says that office expects a "rise in referrals of potential fraud or corruption cases" because of the recent deployment to Iraq of additional

Pentagon investigators and FBI ag

Democrats on the House Govern Reform Committee have identified than 50 "problem" contracts worth a timated $21.3 billion that they say ar der scrutiny by federal investigators that's just what has been publicly closed: Federal officials won't di other pending investigations becau

POLICE TRAINING Civilian contractors have played vital roles in Iraq

recy insulating some of the contracts
l most of the inquiries. All told, the De-
se Dept. has spent more than $365 bil-
n on the Iraq war and the global fight
inst terror since late 2002. Roughly
0 billion, or 16%, of the total has been
d to contractors for services, according
he Congressional Research Service.
The use of private companies and individuals to support the military began in earnest in the 1950s during the Korean War, when the Pentagon hired outside firms to help maintain helicopters. Outsourcing spread in the 1980s as the Reagan Administration sought to privatize government functions generally. The end of the Cold War inspired a broad push by the Clinton Administration to shrink the military and start closing unneeded bases. Those moves resulted in additional outsourcing of food, transportation, and other services.

Bipartisan legislation Congress passed in the 1990s reduced oversight of contractors in the name of increasing efficiency. But as the number of Pentagon contracting officials was trimmed by about 38% during this period, some contractors "exploited the new freedom," says Frank Camm, a senior economist for defense contracting at Rand Corp.

Other safeguards were lifted in the runup to the Iraq war. By law the Pentagon can circumvent competitive bidding rules in "emergency" situations such as war. The volume of sole-source and other noncompetitive contracts awarded by the military has soared 54% since 2000, from $65 billion to $100 billion.

Bush critics say the absence of competition invites waste and corruption. "The flawed contract approach has greatly contributed to the problems," says California Representative Henry A. Waxman, ranking Democrat on the Government Reform panel. "Instead of competition, the Administration has awarded monopoly cost-plus contracts to favored contractors like Halliburton."

But the situation isn't clear-cut. Since the American invasion of Iraq in 2003, skeptics have questioned Halliburton's role in the war, emphasizing that before becoming Vice-President, Dick Cheney headed the Houston company. The Army confirmed earlier this month that it was ending a multibillion-dollar, 10-year contract held by Halliburton subsidiary Kellogg, Brown & Root to provide food, water, shelter, and other basic services to troops. The Pentagon, which has paid KBR $15 billion since 2001, plans to divide the work among four contractors, with KBR permitted to bid for a portion of it. Earlier, Defense Dept. auditors had labeled $1.2 billion in KBR charges as "excessive," "duplicative," or otherwise questionable. KBR officials say its costs were reasonable considering that the work was done under "extraordinarily hostile conditions." KBR also says it has resolved most of the audit disputes with the Army.

KBR's contentions received implicit support from a CBO study issued in October, 2005. The Capitol Hill budget agency examined KBR's work in Iraq during a 12-month period ending in mid-2004. To perform the tasks KBR completed, the U.S. Army would have had to recruit 41,000 additional troops and spend $8.2 billion, or $2.8 billion more than KBR's costs, the CBO found. Over time, the Pentagon would save billions more by employing KBR, the study projected.

Whether the government is able to take full advantage of such cost savings depends largely on whether it can rein in contract abuse. Authorities on military contracting say there are obvious steps the Pentagon can take: It could bolster the ranks of procurement staff and institute tougher procedures for awarding and reviewing contracts. But apart from the scrutiny of the large KBR contract, the Pentagon has no plans to make those moves. In fact, the military expects to further reduce its procurement oversight corps.

Smith, the former CIA general counsel who now represents contractors at Washington law firm Arnold & Porter, predicts that without more oversight, military outsourcing will saddle the government with the wrong kind of business partners. "Iraq has attracted patriots and crooks—and there were probably some crooked patriots," he says. "We're going to be cleaning that up for years to come, I fear."

Outside Help

Pentagon payments are rising to contractors who provide food, shelter, security, and other services *

2000	$53 billion
2001	$56 billion
2002	$65 billion
2003	$85 billion
2004	$94 billion
2005	$104 billion

*Doesn't include weapons or research and development
Data: Government Accountability Office

Renault-Nissan: Say Hello to Bo

GM's purchasing czar is eagle-eyed, ruthless with suppliers, and out to save $2 billion a year

BY DAVID WELCH

KIRK KERKORIAN'S PROposed shotgun wedding of General Motors Corp. and Renault-Nissan Motor Co. rests largely on one big premise: that the trio could save billions and race new cars to market by mashing up their engineering and purchasing might. Both sides are now weighing the idea's pros and cons. But before rushing into a deal, Renault-Nissan CEO Carlos Ghosn might want to talk to Bo I. Andersson.

Andersson is GM's purchasing czar. Few have a better understanding of the inefficiencies hobbling the world's No.1 carmaker. Besides, Andersson is Ghosn's kind of guy. He aims to whack $2 billion from GM's purchasing bill every year indefinitely and ax many of its 3,200 suppliers. Andersson expects results and will go to the mat to get them. A former Swedish Army officer who came up through the ranks of GM Europe, Andersson, 50, is a seriously hands-on individual. He zealously tracks every quality glitch, delay, and snafu on his BlackBerry—then calls the supplier to find out what's up.

The relentless attention to detail comes with the territory. Andersson buys a staggering $85 billion worth of wheels, axles, seats, bolts, and other parts each year, a purchasing bill that's second only to the U.S. military's. So he has a lot of buying power and has taken GM's hard line with suppliers to a whole new level. "GM's purchasing people know the one way they can get costs down is to be brutal," says a parts executive, who requested anonymity for fear of offending the indomitable Swede.

But if slashing $2 billion a year in parts costs was simply a matter of squeezing suppliers, Andersson would be on easy street by now. His job is a lot more complicated than that. Andersson would like GM vehicles to share more parts, the way Japanese automakers do. That's a hard thing to do at the best of times, let alone at a company of GM's size. Andersson is also fighting his employer's legendary bureaucracy. He often finds himself asking questions like, 'Why do we have two dozen different seat frames?', only to get answers like, 'We've always done it this way.' "Sometimes," Andersson says, "we are our own worst enemy."

When he became General Motors' vice-president of global purchasing in 2001, Andersson inherited a sprawling mess of redundancy. It reminded him of his days in Europe in the '90s, when GM brands Saab and Opel manufactured similar cars within a few hundred miles of each other but engineered them separately and built them from many different parts.

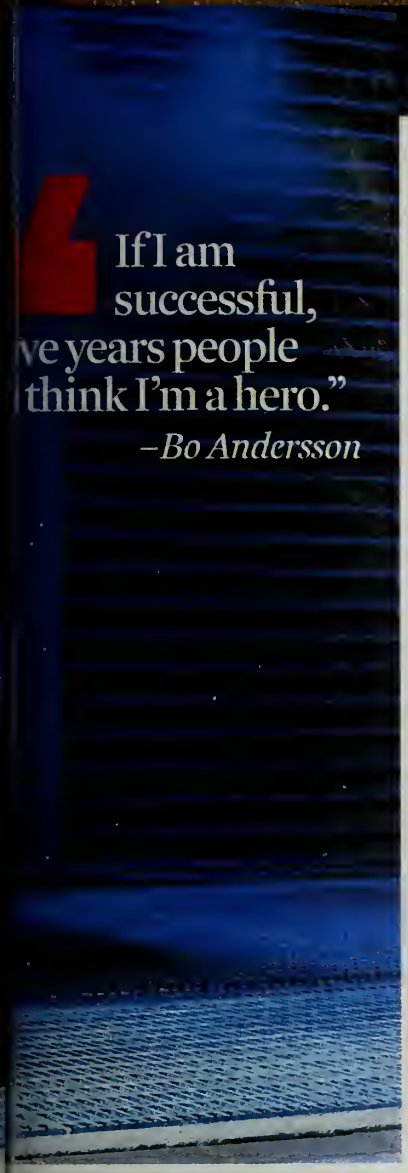
> Even tiny fixes get debated to death. Is there a cure?

Until 2000, GM's North American operations had completely separate engineering groups for cars and trucks. And within those groups were separate teams for almost every type of vehicle the company made. With each team working independently, the engineers and designers had no idea how much money was being wasted making different versions of the same things. The process is akin to a parent of six cooking six different menus—chicken and broccoli for Jimmy, steak and peas for Susan, and so on. It didn't make much sense.

And it has led to serious absurdities. Consider the lowly seat frame, the steel latticework that provides support, comfort, and safety as you tool along the highway. GM makes 26 different versions. Toyota Motor Corp.: two. Engineering a seat frame for a new model can cost million. Add it up and GM has a half lion-dollar handicap vs. Toyota on frames alone. There's a similar gap engines. GM makes a dozen V6s; To and Nissan make do with a few. Chairman and Chief Executive Richard (Rick) Wagoner Jr., who had Andersson's job, is stating the ous when he says: "The opportuniti save are tremendous."

FIGHTING OVER A HINGE

EVEN BEFORE TAKING the top purc ing job, Andersson was part of comp wide efforts to break down the silos in GM and get divisions talking to one other about how to share parts and money. But he continues to stru against hard realities. Simplifying making one part work for a bunc models isn't simply a matter of desig and producing it. GM usually need wait for a new car launch before ma big changes to the underlying p Why? Because suppliers are alr geared up to build hardware for exis



"If I am successful, ve years people think I'm a hero."
–Bo Andersson

models and would require millions in upfront payments to retool their factories. So GM can move only so fast.

A couple of years ago, Andersson discovered that door hinges on big SUVs and trucks could be made out of three pieces instead of five. Doing it that way would save $21 a truck, or about $100 million over several years. A no-brainer, right? Except that building a new hinge involves months of testing, which includes programming a robot to slam a door a few hundred thousand times. That itself costs plenty of money, so the engineers wanted to make sure it was worth it.

Eventually Andersson prevailed, in part by pointing out that a rival uses a similar hinge for most of its trucks. Still, the debate went on for three months at a company where time is not exactly a luxury. Says Terry Woychowski, chief engineer for big trucks: "Don't underestimate the fight you can have over a hinge."

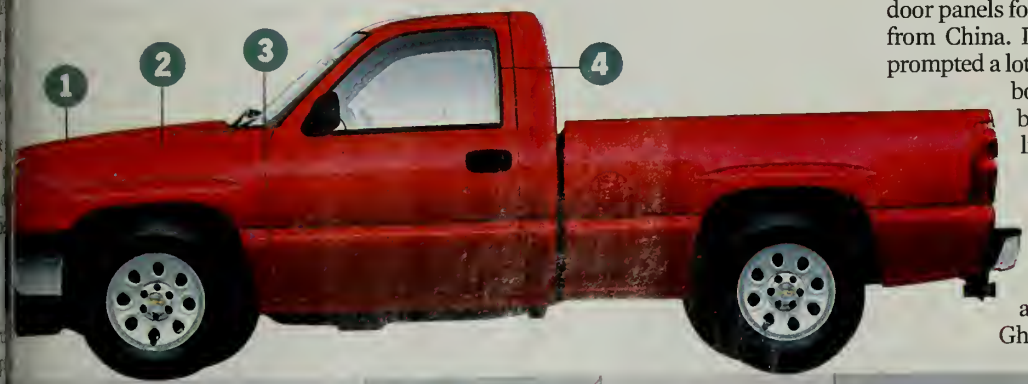
Andersson still has plenty of work ahead cutting through the clutter inside GM, but he has made quick work of weeding out weak suppliers. In part, he is using the consolidation roiling the industry to dump them. But GM has a reputation for particularly aggressive tactics. Andersson is cracking down on the most egregious of these, but GM continues to rank dead last in an anuual supplier satisfaction survey. "It's a brutal process," says David E. Cole, who runs the Center for Automotive Research in Ann Arbor. "There are bodies laying by the side of the road."

Suppliers point to one particularly nasty tactic: shopping their technology out the back door to see if rivals can make it cheaper. In one case, a GM purchasing manager showed a supplier's new brake design to Delphi Corp. Andersson let the guy go. But in a recent survey from Detroit research firm The Planning Edge, parts executives said they tend to bring hot new technology to other carmakers first. Yet another reason GM finds it hard to compete.

Andersson hasn't much sympathy for weaker suppliers. He figures many of their problems—high costs, massive debt, unproductive plants—are self-inflicted, just as they are at GM. But if they won't match his standards, he has no compunction about yanking the business, even if doing so forces the supplier into Chapter 11. That's what happened to Dayton (Ohio)-based wheel maker Amcast Industrial Corp. The company had just emerged from bankrupcty protection last year when it immediately demanded a steep price hike for its wheels. GM refused and Amcast was back in Chapter 11.

Naturally, Andersson sees outsourcing to low-wage redoubts or inviting foreign companies to set up shop in the U.S. as fair play. One recent Friday morning, he held the weekly "knock meeting," a ritual where purchasers approve parts buys. The buyer approaches Andersson and his team much like vassals appealing to their lords and masters in a medieval star chamber. When managers approve of a pitch, they knock loudly on the table. So it went with a proposal to save $30 per car by sourcing door panels for all of GM's midsize models from China. Lately, the China angle has prompted a lot of knocking. Andersson has boosted GM's Chinese parts bill by 60%, to almost $3 billion, since 2003.

That doesn't make him popular, but Andersson is unrepentant. "If I am successful," he says, "in five years people will think I'm a hero." Sounds like Carlos Ghosn, doesn't he?



How Many V6s Do You Need?

M makes too many of almost verything—which Andersson trying to change

1 FUEL PUMPS
Once GM had 20. Now it has 6, and it wants 5. It can use the savings to make better interiors and other improvements.

2 ENGINES
Right now, GM makes 12. Toyota and Nissan make a few. GM aims to save millions by cutting back to 2 V6s.

3 DOOR HINGES
Moving to a simpler design caused a ruckus inside GM but will save $100 million over the next few years.

4 SEAT FRAMES
GM has 26 of them, Toyota has only 2—adding up to a cost disadvantage of nearly $500 million.

AOL: For Once, A Smart Shopper

Advertising.com, snapped up in 2004, now provides most of the company's good news

BY TIMOTHY J. MULLANEY

AT TIME WARNER INC. they know something about troubled mergers. After all, the company has never recovered from the entertainment giant's disastrous 2001 coupling with America Online Inc. So critics sneered when Time Warner bought startup Advertising.com Inc. for $435 million in 2004. One newspaper dismissed Ad.com as a tool for spammers pushing penile enhancement.

Today that obscure startup may hold the key to AOL's future. On Aug. 2, Time Warner is expected to announce a plan to tie AOL's fate even more tightly to advertising, phasing out $2 billion a year in already-shriveling subscription revenue. Such a radical move would be unthinkable without Ad.com, which provides almost 20% of AOL's ad revenue. Its sales doubled to $259 million between 2003 and 2005.

Even with Ad.com, AOL's plan is a stretch. Ad.com will need phenomenal growth to cover just half the lost subscription profits. But without it, AOL would be toast. "If AOL had not purchased Ad.com, I don't think there would be an AOL today," says Jeff Lanctot, general manager of Avenue A/Razorfish, the largest Internet ad agency.

It's hard to dispute Ad.com's recent track record. The company buys ad space from 3,000 sites and resells it to about 500 clients, employing technology to steer ads to the users most likely to act on them. Nearly half of the growth in AOL's ad sales in 2005 came from this unit. Its partner sites reach 144 million Americans a month, says Ad.com President Lynda M. Clarizio, about 30 million of whom don't visit any AOL sites. And momentum is strong. In the first quarter of this year, Ad.com expanded a deal with its largest client, Apollo C Inc., parent of the University of Phc Industry insiders say the deal, whos tails are secret, could bring in $30C lion worth of ads over three y "Ad.com has probably been the mos cessful acquisition in [AOL's] hist says AOL Vice-Chairman Ted Leons

Now, Time Warner hopes Ad.con solve two of AOL's biggest mistake lowing the megamerger. The first w failure to expand its advertising base or to purchasing Ad.com, the com only sold ads on AOL.com, other com owned sites, and the flagship AOL se By contrast, Google Inc. sells bot Google.com and on sites owned by ners. Such alliances brought Gc $928 million in ad revenue in the quarter of 2006. AOL is starting t Ad.com's relationships, hoping to g its advertisers' spending all over the

AOL's other mistake was arriving to the market for search-related Wel which it now sells only through a nership with Google. AOL think next big market is ads related t line video searches, which ar part of the Google deal. It wa target ads embedded in str ing video, both at AOL's Web sites and at partner sit

PAY FOR WHAT YOU GET

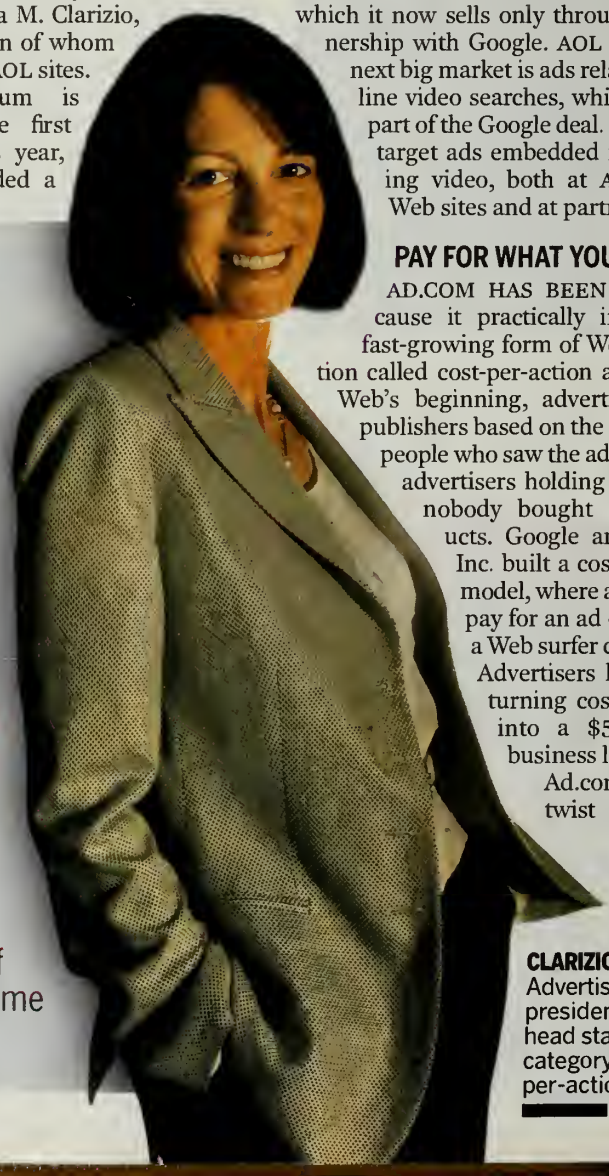
AD.COM HAS BEEN A hi cause it practically invent fast-growing form of Web pr tion called cost-per-action ads. I Web's beginning, advertisers publishers based on the numb people who saw the ads. Tha advertisers holding the b nobody bought the p ucts. Google and Ya Inc. built a cost-per- model, where advert pay for an ad only v a Web surfer clicks Advertisers loved turning cost-per- into a $5.1 bi business last ye Ad.com's sp twist is th

144 million
The number of Americans that Advertising.com reaches through its partner Web sites

Data: Advertising.com

$259 million
Revenue in 2005 from Advertising.com, accounting for half the ad growth at Time Warner's AOL unit

Data: Time Warner Inc.



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charges most advertisers only when a consumer takes a real action—buying something, or giving the advertiser a phone number for a follow-up call. In a 2005 campaign for Volkswagen, for example, Ad.com got paid for the 19,000 consumers who configured their ideal Jetta at vw.com and 12,000 who requested more information. VW didn't pay for millions who saw the ad but didn't act on it. Ad.com Chief Marketing Officer Mollie Spillman says about half of the company's business is cost-per-action deals, with the rest coming from cost-per-click, consulting, and cost-per-thousand-viewers agreements.

AOL's shrinkage could wipe out Ad.com's upside

Here's how the system works. Ad.com buys cheap space and then adds its own targeting technology, which uses the results of past ad campaigns to decide who should get current ads. The targeting lets Ad.com charge a premium. Competitors from aQuantive Inc. to MSN and Google are now experimenting with cost-per-action, angling for the $50 billion a year that companies spend on direct-response marketing.

So how much can Ad.com really do for AOL? Merrill Lynch & Co. analyst Jessica Reif Cohen estimates that within two years, AOL will lose up to $250 million in annual profit before noncash charges as a result of shrinking its subscription business. That's about 14% of AOL's earnings, far more than Ad.com can make up for, even with $300 million to $400 million in likely 2006 sales and margins in the high teens. AOL won't talk specifics, but for the plan to work, Ad.com would have to double its current profits a0nd AOL's fast-growing search-ad business would have to make up the rest. Piper Jaffray's Safa Rashtchy says AOL's shrinking audience is a bigger problem than Ad.com can solve. "It's not a panacea," he says.

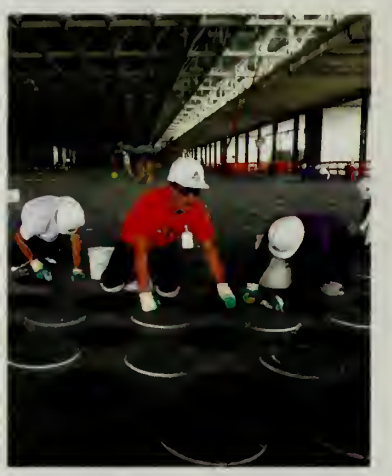
But in Ad.com's Baltimore neighborhood, they know from tough fights, too. Just down the Patapsco River is Fort McHenry, where Francis Scott Key once watched a different army take a pounding. If Time Warner's darkest hours finally pass, maybe Ad.com will ensure that AOL's flag is still there.

Intel Sharpens Its Offensive Game

After another rough quarter, it's rolling out new chips to counter archrival AMD

BY CLIFF EDWARDS

FOR MONTHS, MOST OF THE news from chipmaker Intel Corp. has been bad. With rival Advanced Micro Devices Inc. logging steady gains in the markets for PC and corporate server chips, Intel's inventories piled up, pushing its gross margins last quarter below AMD's for the first time. Meantime, its stock is trading at about $18, down from a peak of $29 a year ago. And on July 19, Intel reported another disappointing quarter, with revenues sliding 13%, to $8 billion, and net income falling 57%, to $885 million.



NEW FAB Intel pla squeeze more transistors onto

Now Intel's prospects may be about to brighten. After two years on the defensive, the company is launching a major counterattack. This spring, Intel began lowering prices, taking $200 out of the cost of some PCs running its chips. And on July 27 the Santa Clara (Calif.) chipmaker will introduce a new family of processors, called the Core 2 Duo, that combines the performance of its Pentium 4 desktop chips with the energy-saving features of its processors for notebook computers. "We intend to energetically compete for every single microprocessor opportunity in the industry," says Intel Executive Vice-President Sean M. Maloney.

Analysts say the chips beat AMD's at most tasks and should help Intel win back PC market share. But, they point out, AMD is entrenched in the market for corporate servers and won't easily be dislodged. AMD President Dirk Meye he'll do whatever it takes to compet cluding cutting costs and slashing prices: "We're going to continue ning business by making sure we' smarter choice for our customers."

If there's an all-out price war, Int the advantage. Thanks to new man turing techniques at three giant p that squeeze more transistors o chip, its processors cost less to than AMD's. That allows Intel to lower prices without the dramatic declines it suffered over the past AMD won't be able to match Intel's ufacturing techn until mid-2007.

So Intel is in sition to win lion's share of w expected to be biggest PC up cycle in more six years. Dema predicted to pic because of the awaited arrival o crosoft Corp.'s dows Vista operating system. Vista out later this year for business PCs early next year for consumers.

While some analysts worry that ing economic growth could hur sales, Intel is betting it can work c inventories—now at a record level- hurt AMD, too. Even as it pushes its higher-end chips, Intel will contin use its old warhorse, the Pentiu lure budget-conscious consumers. gamble. But Intel aims to take ac tage of the brief window it has b AMD retaliates.

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The Show Within a Show at NBC

A behind-the-scenes battle to land Aaron Sorkin's big-buzz drama, *Studio 60*

BY RONALD GROVER

A TV NETWORK WITH THE media world's squarest parent would never go for a show like this. Or would it? When executives at General Electric's NBC caught wind of a hot script lambasting a wobbly network just coincidentally called NBS, they mounted a fierce battle to win the show, set to premiere in September. Now the buzz around Hollywood is that *Studio 60 on the Sunset Strip*, a slick hour-long drama from superstar writer Aaron Sorkin, may be just what NBC desperately needs to lift itself out of a four-year ratings funk.

A sharp-tongued drama, *Studio 60* tells the story of a comedy program much like NBC's *Saturday Night Live*, gleefully skewering egoistic creative types, backstabbing executives, and government-fearing corporate lawyers along the way. They may have smarted over the material, but NBC executives clearly saw the fast-paced script as a chance at deliverance. The creator of NBC's long-running hit *The West Wing*, Sorkin has invented two complicated lead characters, complete with histories of substance abuse, who return to NBS to help bail out a show in crisis. The irony wasn't lost on the NBC suits: Sorkin parted ways with the Peacock Network three years ago over a blowup that followed his own well-publicized drug problems.

Taking a second chance with the 45-year-old Sorkin was an admission that NBC needed that one monster hit to help resuscitate its prime-time reputation, just as *Desperate Housewives* changed the game for floundering ABC two years ago. "We're coming off a couple of tough years, and we saw this is as the kind of entertainment that would bring folks back," says NBC Entertainment President Kevin Reilly, whose future at the network may well be riding on *Studio 60* and the whole fall lineup. Consider that NBC's ratings have declined 25% since 2002, and that the once-invincible network finished fourth last season to Fox, ABC, and CBS among 18- to 34-year-olds. With a string of flops in recent years, NBC will launch six new shows, about a third of its 17-show schedule. Improbably, one of them is yet another *Saturday Night Live*-like parody called *30 Rock*. The half-hour comedy, created by and starring *SNL* headliner Tina Fey and featuring Alec Baldwin, was already in development when the Sorkin talks began.

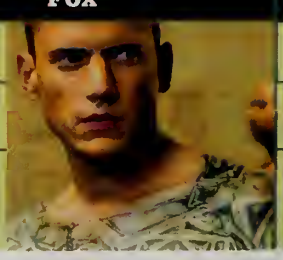
From the outset, NBC counted heavily on *Studio 60*, giving it the high-profile Thursday night 9 p.m. slot once occu by *Seinfeld* and *Cheers*. But even befo first airing, the plan was short-circu ABC outmaneuvered its rival and m its own powerhouse, *Grey's Anaton* the same time, forcing NBC to shi show to Monday at 10. It's a spot tha be nurtured, says Sorkin, because F filiates shift from entertainment to programming at that hour. "Of co now we expect ABC to shift the S Bowl, Academy Awards, and a Presid debate to Monday nights," Sorkin qu

EDGIER FARE

THE STORY BEGAN six months e when Reilly, who returned to NBC second stint in 2003, heard that S wanted to come back to TV with a s loosely based on his last turbulent ye *The West Wing*. Reilly says he immed peppered the writer with phone call e-mails. Sorkin began working in ea on the script last summer in a hotel in London while overseeing a revival play *A Few Good Men*. If anyone was

Rolling the Dice on Prime Time

	CBS	Fox	The CW**
NUMBER OF NEW SHOWS*	6	7	6
NUMBER OF NEW '05 SHOWS RETURNING THIS FALL	4	3	2
RATINGS RANK FOR TOP RETURNING SHOWS	*Criminal Minds* (30th)	*Prison Break* (62nd)	*Everybody Hates Chris* (159th)



*Shows that premiered fall, 2005 **Includes shows from UPN and The WB, which merged to create The CW

THE PLAYERS NBC President Kevin Reilly (right) and the star-studded cast of *Studio 60*

ed that NBC could get burned trying to w its ties with Sorkin, no one said so. anted to be in business with Aaron in, who has the kind of sensibilities appeal to an NBC audience," says ly, who learned a thing or two about g chances on edgier fare as a top pro- mmer at FX Networks, where he nlit the hit cop show *The Shield*.

lthough Reilly and Sorkin knew each r from earlier days, old ties don't al- s count for much in Hollywood. Busi- s was business. So, backed by Warner s. Television Group, Sorkin and his ner, Thomas Schlamme, along with r agent, Ari Emanuel, decided to stage essure-packed bidding process. They e the networks a weekend to read the pt and commit to the show. The re- nse was high-voltage. CBS bid higher n it originally wanted to, say those with wledge of the bids. And both dis- hed their heavyweights: CBS Presi- t and CEO Leslie Moonves and NBC versal Television Group CEO Jeffrey A. ker each blitzed Sorkin and Schlamme with calls to their homes in Santa Monica. "It got so bad that we had Ari field the calls so we could get some work done," says Schlamme.

THE NUMBERS

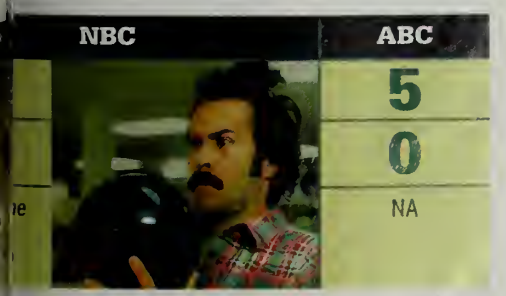
NBC WAS UNDER enormous pressure to win. At the time of the bidding, the network was sinking fast in the ratings, and NBC execs, from Zucker to Reilly, were in the hot seat after ad sales had dropped for the first time in years. GE Chairman Jeffrey Immelt began to spend more time on NBC's woes. So Reilly moved quickly. He got the script on a Friday night and overnighted a copy to Zucker in New York. "By Saturday night we were into the numbers," says Reilly. NBC won the bidding with a $2 million an episode licensing fee (the average for a first-time show is about $1.4 million, say sources).

Emanuel insisted on other benefits, too: a 13-episode commitment (half a season) with a massive financial penalty for early cancellation. The producers were assured of a decent night and time slot, and Sorkin won artistic control. In a break from current network practice, the show was granted a large marketing budget—$10 million, according to knowledgeable sources—that included photo shoots and online clips produced by high-end photographers used by movie studios. NBC declined to comment on the marketing budget. The campaign also includes extensive promotions on video site YouTube and a Hollywood-style premiere five days before the show's Sept. 18 debut.

Deal in hand, the *Studio 60* duo went to work signing a star-packed cast that now includes Amanda Peet and Steven Weber along with *West Wing* alums Bradley Whitford and Timothy Busfield. One key challenge was wooing *Friends* star Matthew Perry, who could help the show take off, Reilly says. But Perry was being pitched by several producers and was mulling other NBC projects. "There were all [these] silly money projects coming his way from every agent in town," says Reilly. Once Perry read the script, however, he agreed to play the part of disillusioned writer Matt Albie, recalls Sorkin.

The pilot, which cost a hefty $6 million to make (the *Desperate Housewives* pilot cost $5 million), has won high praise from critics and, better yet, major Internet buzz. Consultant Brandimensions Inc. says *Studio 60* was talked about in 22% of online chat discussions from mid-May to mid-June, more than any of the other new shows. That compares with 9.3% for NBC's *Heroes* and 5.5% for CBS' nuclear disaster drama *Jericho*. NBC has helped by offering clips of *Studio 60* to Internet sites and will soon send free promo DVDs to Netflix customers. Although some advertisers worry that *Studio 60* will be too inside-Hollywood for a broader audience, Andy Donchin, whose ad agency Carat North America has bought time on the show for clients Black & Decker, RE/MAX, and others, says the show will play to NBC's traditionally higher-income urban viewers.

That puts a heavy burden on Sorkin to dazzle with the scripts that once made *The West Wing* a watercooler favorite. Sorkin, who is in recovery, says he is reenergized. He has already penned six scripts, quite a feat for a writer with a reputation for being painfully slow. And he's not pulling any punches. In the pilot, guest star Judd Hirsch lambastes the loss of TV standards and rails against shows on which "contestants eat worms for money"—an obvious swipe at NBC's lowbrow show *Fear Factor*. Sorkin says NBC's Zucker laughed at the barbs and told him to keep them coming. Maybe, just maybe, *Studio 60*'s self-referential humor will help spark a turnaround. "If he's going to [lampoon NBC]," says Reilly, "it's better he does it on our air than on someone else's."



Data: Horizon Media, Nielsen Media Research

A Little Money Goes a Long Way

Using the power of social networking to help small businesses around the world

BY JESSI HEMPEL

ANN BROWN AND MARIA Martinez have never met, but last March Brown loaned Martinez $50. It was part of a $400 loan Martinez needed to get her clothing store up and running in Danli, Honduras. She used the cash to buy colorful hairbands, bright shirts, frilly button-downs, and baby onesies. Sales have picked up, and now Martinez is paying Brown back in monthly installments via the Web site on which they found each other, Kiva.org. "When I was starting my handbag business, a neighbor wrote me a check for the startup capital," says Brown, who sells bags at the Pike Place Market in Seattle. "I had nothing, and that made it possible for me."

Friends and neighbors have been lending one another money forever, but as the Web makes virtual neighbors of strangers, Kiva, which is Swahili for "agreement" or "unity," is harnessing the power of social networking to support microenterprise in the developing world. From Honduras to Uganda, microfinance institutions post MySpace-like profiles of people who need capital to start or expand their businesses. Then lenders—aka you and I—can sift through pages of business ideas and grant loans in increments as tiny as $25. PayPal processes the transactions for free, and lenders receive monthly repayments. The lender is out the money if entrepreneurs don't pay up, but microcredit has earned a reputation for high payback rates. In the five months since its launch, says Kiva, the site has had no defaults. It has processed $200,000 in loans, disbursed among 450 entrepreneurs.

That might not seem like a lot of money. But a little goes a long way. A $500 loan through Kiva has changed Elizabeth Omalla's life. The widow from Tororo, Uganda, supports 11 people by selling fish. Thanks to the loan, which she already has repaid, Omalla now sells more varieties of fish and, as she blogs on Kiva, has been able to "take my children to school, buy two cows five goats, and open a savings accou It's this one-to-one interaction that microfinance advocates praising model. Says Alex Counts, presider Grameen Foundation, the pioneer microcredit institution: "Kiva could awareness about microfinance an people who might not otherwise l about it."

BUSINESSWEEK SmallBiz

Microloans, Maximum Effect

Money invested through Kiva since March:

$200,000

Entrepreneurs who received that money:

450

Data: Kiva.org

BYPASSING LOCAL BANKS

KIVA GOT STARTED as an experimer ter Stanford Business School stud Matt and Jessica Flannery traveled to Africa to review projects for the micr der Village Enterprise Fund. They no that VEF, like many of the 10,000 m lenders around the world, had to rel local banks to provide capital for the l it disbursed. These banks often charg terest rates of 12% or more. Becaus microlenders must also cover hefty ministration fees, loan recipients us paid as much as 35% in interest. Flannery knew of Web sites such as l per.com and Zopa.com let folks in the U.S. and rope extend personal l to one another. Why globalize it? The micr ders would bring loan requests direc Kiva, cutting out local banks. Alth they would still charge some intere cover overheard, Kiva hoped t the cost of loans in half.

Within a year the couple go site up and running. Matt qu day job as an application d oper at TiVo Inc. and recr former PayPal executive Pr Shah to help run it. Kiva since been inundated with p tial investors, particularly po school types in search of a so meaningful side of the corp world. Bill Gilroy, a 33-year-old president at private-equity firm C al Reach Capital, invested $100 las He has received $20 back so far. "I an e-mail blast out to 150 friends, says, "and many have told me th [loaned money], too."

As the number of microlenders nering with Kiva grows, some cause proving more popular than others. ows in Africa are almost always fu immediately, but men in Central Am often have to wait longer. The Kiva plans to experiment with higher int rates on less popular causes to hel tract funders. With a bit more tinke they believe, the power of market f will fix the disparity.

~~don't know anything about graphic design.~~

~~my business is too small to afford high-quality printing~~

only go to stores that play instrumental versions of my favorite rock songs at a low volume.

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For Your Eyes Only

Mini Cooper's campaign, aimed just at owners, looks to enhance the car's cachet

BY BURT HELM

WHY WOULD AN automaker spend hundreds of thousands of dollars in advertising to reach people who already bought the car? Go ask Mini USA. In the next few weeks, the company will launch a series of ads in magazines ranging from *Maxim* to *The New Yorker* aimed just at their current 150,000 U.S. owners. Potential customers won't even be able to read what's on the page.

That's because the ads will be encrypted, decipherable only by the cognoscenti. Mini is sending owners a "covert" kit—mocked up as a wizened-looking book—that will include special glasses, a decoder, and a "magic window decryptor." Using those, owners will be able to find Web addresses in the ads that lead them to free prizes and invitations to events. Nonowners will just have to feel slightly jealous that they're out of the loop.

The strategy is to get owners buzzing about the brand while piquing the curiosity of potential buyers. "It's a covert and an overt campaign almost simultaneously," says John Butler, a creative dire Butler, Shine, Stern & Partners, new ad agency. "If you get the kit, rewarded. If not, you get the gis owning a Mini is like being in a clu

The prizes perpetuate that clubb The first will be an invitation t Mini's upcoming "Mini Takes States" event, a cross-country where hundreds of Mini Cooper drive from Monterey, Calif., to Lak Conn. Another, following the spy will be joke switch covers for the dashboard, like one that labels th light switch "ejector seat."

Luxury carmakers have dangled in front of their drivers for some ti course. Infiniti owners receive invit to panel discussions from noted desi and architects. New buyers of B high-powered models can atten BMW Performance Center for daylo vanced driving classes. Jeep does thing similar with "Camp Jeep." approach is more wacky than pos keeping with the owners of the ecc $18,000 Mini Cooper.

Inside the Mini **Spy Kit**

Sent solely to owners, it's a playful way to generate buzz around the brand

"SECRET" BOOK Although it m blend in on a shelf, the covert more cutesy than crafty. The cardboard book won't fool any

DA MINI CODE Magazine reade jumbled text. With the decoder, owner can make out the addres site that contains special offers.

MAGIC WINDOW The ridges on plastic window bend and block li arranging snowy fuzz on the roo Mini pictured in an ad into a mes

I SPY SWAG Those rose-tinted shades may look dorky, but Mi bets owners will don them if it means getting free car access

ashion Emergency At Wal-Mart

ioppers are ignoring the racks. Can the ain change its style-challenged image?

ROBERT BERNER

WALKING THE APparel and accessories aisles at the Wal-Mart in Secaucus, N.J., Edward Stephens is quick to find fault. Women's running short on the more upscale orge clothing line, and a sales associate s slipped in dissonant items from the ndier Metro7 brand. The strongest de-rtment in men's—printed T-shirts—es the back wall, making it hard to see. omen's size 5½ shoes are out of stock. en there's the swimsuit cover-up that s as much style as a potato sack. Blurts phens: "That's horrible!"

Stephens, part business analyst, part hion expert, part spy on the competi-n, is one of a 340-strong army of "fash-n merchants" at Wal-Mart Stores Inc. al-Mart and fashion? It may seem like ling Cheez Whiz at Chanel. But as Wal-art moves into heavily stored metropoli-tan areas, it needs these foot soldiers to apply more analysis to the surprisingly sloppy approach it has taken with its clothing business. "It is one of the most important positions we have created," says Claire Watts, executive vice-president for apparel. It could also be one of the most daunting, since shoppers hardly view Wal-Mart as a fashion mecca. "Perception is an issue," admits Watts.

The new post is key to addressing Wal-Mart's biggest sales problem. Nearly 130 million customers shop its 3,200 U.S. stores a week. Yet just 45% shop the whole store, estimates research firm William Blair & Co. And 40% of regulars stick to low-margin basics, bypassing higher-margin sections such as apparel. But it is apparel, with gross profit margins about double Wal-Mart's 23% average, that could really drive profits, says Citigroup analyst Deborah Weinswig.

Maria Nissirios is one of the shoppers who buy everyday items. These consumers, with incomes closer to $60,000 than the $35,000 and less of Wal-Mart's traditional customer, tend to buy clothes at Target, Kohl's, or higher-end stores. At the Secaucus Wal-Mart, Nissirios, a 27-year-old architect, loaded up on items like computer screen cleaner, but ignored apparel. "I guess it's kind of [a] mindset," she says.

PERISHABLE GOODS

TO CHANGE THAT, Wal-Mart is trying to make its stores more inviting. TSN Media Intelligence shows that Wal-Mart cut overall ad spending by 6% in the first quarter, including a 23% cut in TV advertising. Analysts say some of that money is instead being used to jazz up store interiors. A year ago, Wal-Mart's primary advertising focus was TV. Now, says Wal-Mart marketing head John Fleming, "the most important media channel is the store."

Stephens oversees five stores in New Jersey, including the one in Secaucus, Wal-Mart's closest to New York City. A former supermarket manager, Stephens, 36, was on the grocery side before becoming an apparel department manager. He leapt at the chance to become a fashion merchant last summer, and even began ordering *Vogue* under his wife's name to keep up with trends.

TOP COP "Fashion Merchant" Stephens in Wal-Mart duds

Stephens must spend a quarter of his time walking competitors' stores. If he sees something he likes, Wal-Mart's Bentonville (Ark.) headquarters allows him a say in buying decisions. Most important, he and his peers provide a new level of connection with headquarters. Stephens talks to Bentonville buyers some 10 times a week. When he learned that women's size 5½ shoes were out of stock, he concluded that headquarters wasn't aware of the store's large base of Hispanic women, who tend to have small feet—an insight that could aid buying decisions.

Wal-Mart plans to use such feedback to tailor merchandise floor plans and apparel to different markets, such as those that are affluent, mostly young, or Hispanic. But before it can change consumers' perceptions, it must fine-tune its own. That swimsuit cover-up Stephens found so appalling? It flew off the racks.

THE STAT

40

Percentage of regular Wal-Mart shoppers who buy only low-margin basics

ALFANO Her plan helps pay for her husband's premiums

A New Twist on Retiree Health Care

Instead of ending coverage, some companies are turning it into a 401(k)-like perk

BY HOWARD GLECKMAN

THE NATION'S PENSION crisis, it turns out, is only the second-largest long-term liability facing U.S. businesses. Far greater are underfunded health-insurance promises to current and future retirees. The companies that make up the Standard & Poor's 500-stock index are an astonishing $321 billion shy of what they need, according to senior analyst Howard Silverblatt at Standard & Poor's Corp. (which, like *BusinessWeek*, is owned by The McGraw-Hill Companies). By yearend the Financial Accounting Standards Board is likely to require companies to put this liability on their balance sheets, a step that could shrink shareholder equity by as much as 9%.

Many companies have been trimming those costs by dumping retiree health care entirely. In 1993, 40% of large employers offered such benefits to those over 65. By 2005 just 21% did, says Mercer Human Resources Consulting.

But rather than drop benefits altogether, "a lot of clients are saying: 'Let's re-engineer our retiree (health) plans,'" says Edward Kaplan, national health practice leader at consultants Segal Co. A small but growing number of companies are trying one new approach: transforming retiree insurance into a 401(k)-type perk. Instead of promising to pay, say, half of a retiree's premiums, no matter how costly, these companies are setting aside a fixed amount for each pensioner's medical care. After that, retirees are on their own, even if costs top what's in their account.

THE STAT

$321 billion

The amount of unfunded retiree health obligations of S&P 500 companies

Data: Standard & Poor's

About 5% of employers who offer efits have switched to such defined tribution accounts, including Dai Chrysler, which will move manager other nonunion workers into or 2007. An additional 13% have si capped yearly retiree health spen Another 25% are considering changes, Mercer found.

INTEREST ACCUMULATES

EMBARQ CORP., a $6 billion telecon spun off during the 2005 merger of S and Nextel Communications In weighed down with more retirees workers, and its medical obligations be underfunded by up to $600 millic address the problem, the Overland (Kan.) company is setting aside $ for every year an employee works age 50. The money accumulates wit terest but doesn't legally belon workers the way a 401(k) does, th they can use it to buy health cov upon retirement.

Companies such as Embarq are ing with retiree coverage because fear losing an aging but skilled v force. Embarq's average employee his or her late 40s, has 24 years of ice, and highly values retiree ber Embarq switched with the backing unions. Says Randy Parker, direct benefits: "We made a conscious dec to continue coverage because of demographics."

One of the first Embarq retirees t such an account, Alice Alfano, 67, re last year after 17 years at the local p company in the Orlando area. Be she was older than 50 when the pla gan, Embarq credited her with a $32,000 at retirement. That was enc Embarq figures, for a Medicare su ment policy for the rest of her life.

On her own, Alfano would be p $79 a month for a group policy En offers from CIGNA But her husband, 63, is also on her pla the couple will pay a month until he is ble for Medicare a That will eat into a chunk of the funds i Embarq account, bu figures it's better th benefit at all. " knows if I'll live to 85? I'll use the ey...until it's gone, says. For Alfano, at that flexibility is v the long-run risk.

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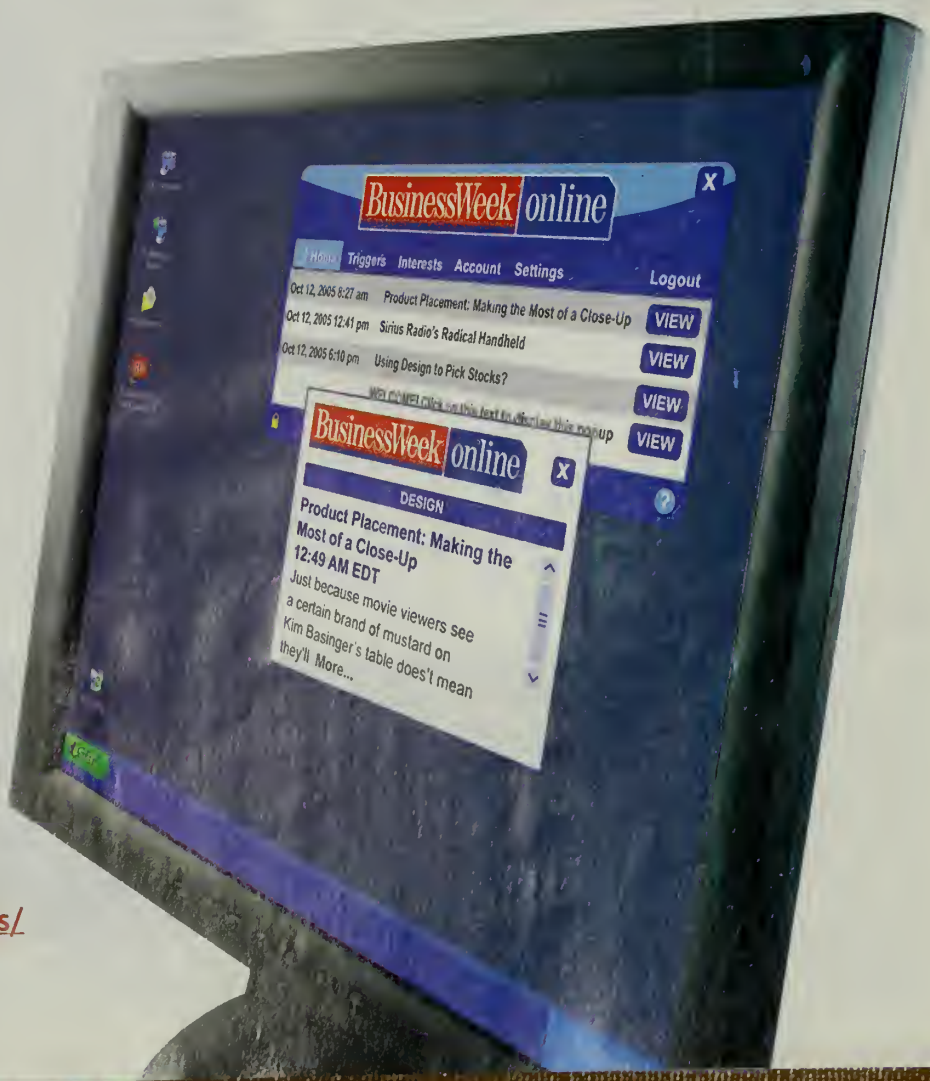

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FAMILY DIARY

BY MICHAEL OREY

Preventive Care Gone Batty

The kids were asleep. A bat may have entered the room. Time for rabies shots?

ON JUNE 26 MY daughter Sophia picked up the phone. It was her friend Kara McGowan. "We all need to get rabies shots," Kara said. It was not the typical coda to a sleepover, with the caller saying something like: "I found one of your socks under my bed." ¶ Three days earlier Sophia and another friend, Emily, had a slumber party at Kara's house to mark their completion of seventh grade. The next day, after their guests had left, the McGowans spotted a bat fluttering between bedrooms on the upper floor of their suburban New York City home. Several hours later, they spied it again in the bedroom where the girls had slept. A local animal control officer outfitted with leather gloves and a coffee can failed to capture the bat, which meant it couldn't be tested for the disease.

Each of the girls' doctors, as well as one from Kara's and Emily's camp, said they should get what is known as post-exposure prophylaxis (PEP) for rabies. It's a series of five vaccine shots over the course of 28 days, plus additional jabs of rabies immune globulin on the d cination begins. The ration bat with tiny, razor-sharp could nip the girls without them or leaving any distinct mark. Sanofi tis, maker of the Imovax brand of vaccine, note Rabies.com Web site that there's an "eerie ring of to the horror tale *Dracula*. "Like Dracula," the site says have crept up on sleeping people, bitten them, and flow

The advice of four doctors and a rabies researcher I c ed was not something my wife and I were going to argu Rabies is always fatal, and, according to the U.S. Cent Disease Control, bat bites have been the source of 92% of human cases in this country since 1990, based on testi can trace variants of the virus to a particular species. T cine is expensive—about $1,500 for the full treatment—b is generally covered by insurance. Some 40,000 Americ ceive PEP every year for bites or suspected bites from bats raccoons, and other critters. (Because rabies has an incu period ranging from a few weeks to many months, the v is effective if given immediately after exposure.)

Something about this race to vaccinate strikes me a nuts. Face it, bats are everywhere. An estimated 1.5 milli under a single bridge in downtown Austin, Tex. You m them at dusk whirling over the lake in New York City's Park. Yes, they get into houses, and about 5% of the bats indoors have tested positive for rabies. Still, just one or tw ple a year die in the U.S. from an undocumented bat b

Bat Stats

The risk of contracting rabies from a bat is extraordinarily low...

- No U.S. bats are vampires
- Only 0.5% of all bats have rabies
- Just 37 people were infected with rabies in the U.S. from 1990 to 2004*
- Oregon authorities expect only one case of bat rabies from an unrecognized bite every 75 years

WE EAT INSECTS, NOT CHILDREN Little brown, big brown, and silver-haired bats are common in the U.S.

...But if you've been around the critters, yo may need shots

- 5% of bats found in homes ma indeed, have rabies
- 34 of 37 U.S. rabies cases had variant that originates in bats
- More than 50% of people with rabies can't document a bat bite
- Almost 100% of cases are fatal**

* Includes four who contracted rabies from a rabies-infected organ donor ** One person is known to have survived the disease

SWOOPOVER? Kara (left) invited Sophia and Emily for a sleepover. A bat was later seen in the room where they slept. Vaccinations followed

fi Dracula scenario. In New York, 82% of the 1,799 en-ters with bats that led to vaccinations in 2005 were based ly on suspicion of exposure, rather than a known bite. Is it ble my wife and I let the horror stories hamper our ability ke a hard-nosed look at the numbers? Have our health ders become infected with hysteria?

I drove Sophia to get her second injection, I thought about c deaths: 0.8 per 100 million passenger miles. I suggested ophia take ibuprofen to alleviate the anticipated soreness, recalled data I'd seen on an often-fatal skin disorder the triggers in some people. It's extremely rare, but is it any so than getting rabies from a bat with no sign of a bite?

fety First

NWHILE, THE RISK decisions seemed to branch out end- and inconclusively. Sophia was about to get on a plane : deaths per 100 million passenger miles) for Israel(!), e she would need to get her last three shots. The package t for the vaccine said it needed to be kept between 35 and grees, but not frozen. Would it suffice for her to transport h cold packs in an insulated bag? And if it got confiscated curity or customs, would it be O.K. for her to continue with nly brand of vaccine available in Israel, which is made by ferent company using a different method? Scientists I e with sounded varying degrees of caution on both of these tions. (My wife and I ended up answering yes to both.)

The issue that vexed me most was the premise that set us down this whole path: that post-exposure rabies prophylaxis is advisable just because a person may have slept in a room with a bat. It turns out that since 1999, CDC guidelines have stated that PEP "can be considered" when "a sleeping person awakens to find a bat in the room or an adult witnesses a bat in the room with a previously unattended child" and "rabies cannot be ruled out by testing the bat." When New York State began publicizing this seven years ago, says Dr. Brendan C. Brady, a physician in Canandaigua, N.Y., his county saw a "huge spike in the money we were doling out for something that basically never happened." The guidelines, he says, are "pretty reasonable," but the interpretation has become "like the Chicken Little story." Now "you'll never get a doctor to tell you not to get vaccinated," Brady says, because they have nothing to gain by advising against it. A 1998 study by Oregon health officials estimated that, because unrecognized bat bites are so rare, it would cost the state $180 million to prevent a single case of rabies from such an incident if the guidelines were fully followed.

I got on the phone with Charles E. Rupprecht, chief of the CDC's rabies section, who acknowledged that the guidelines often fall prey to defensive medicine. Doctors should ask detailed questions to see if PEP is necessary, he says, such as inquiring about where the bat really was and how heavily a person sleeps. (Out of curiosity, he tested his own kids when they were young by pinching them with forceps; they did not awaken.) But "everyone's risk-averse," Rupprecht says, so they "equate what CDC is saying with every time you have a bat in your house you have to get prophylaxis." In some cases, it goes beyond even that. Camps in New York have sent busloads of kids to get vaccinated, simply because bats have flown through their cabins or dining halls—while the campers were awake.

Bat experts scoff at this. Merlin D. Tuttle, founder and head of Bat Conservation International in Austin, thinks people know if a bat has bitten them. He suspects that many bat rabies cases for which the CDC has found no bat exposure might be shown to involve a bite if more investigation were done. That's because the CDC classifies bat rabies cases as being of "unknown" origin unless it can get a credible account of exposure to a bat from the victim or his family. The victims are often dead or deranged by rabies by the time an inquiry is begun.

So where did my reporting lead me on our decision to get Sophia vaccinated? There certainly seems to be controversy about whether to act on a bite that may never have taken place. And the ultraconservative impulse of doctors to proceed with PEP at even the hint of proximity between person and bat seems hard to justify as a matter of health economics.

But in a matter of life and death, I look for consensus, not controversy. I make decisions as a parent, not as a health economist. Faced with the same circumstances in the future—an infinitesimal chance of mortal harm vs. a guaranteed way to avoid it—I'm pretty sure I would do the same thing all over again. One thing I do know: If we find a bat in our house, I'm sending Sophia to catch it.

Vroom Rooms

The garage may be the last frontier of home renovation, but you don't have to l a car collector to see the potential in this once-cluttered space. **BY ELLEN HOFFM**

YOU'VE ALREADY OVERHAULED the kitchen and bathrooms, added a pool house with outdoor kitchen and bar, and organized the closets with modular storage systems. What's left to improve? Hint: Have you looked in your garage lately? ¶ Once a cluttered repository for garden tools, miscellaneous junk, and maybe even your car, the humble garage is going designer. For many, it's the last frontier of the complete home makeover, a big open room that can be converted to a spacious showplace for a car collector or an activity center for the hobbyist.

You can go as far as your imagination and budget allow. Baton Rouge architect Kevin Harris is designing a $1 million, 4,000-square-foot, four-car garage for a client who wants walk-in storage closets, elevator access to the house, and pet condos for 10 dogs and cats (with videoconference facilities so the owners can keep in touch with their animals when they travel).

In part, garages have gotten bigger to accommodate such multiple roles. Today, 15% of new homes have a garage large enough for three cars or more, according to the National Association of Home Builders. In 1992, it was just 6%. Archway Press, a New York company that sells detailed blueprints for houses and garages, has been ramping up the size and complexity of its garage designs to meet demand. For example, one Archway blueprint gives plans for a free-standing, 10-car structure with a 2,700-square-foot apartment above it.

A garage's main purpose continues to be storing cars, but that doesn't mean it has to look like a garage. Driving into David Rodrigues' four-car garage is like entering your family room. The Pewaukee (Wis.) builder spent $20,000 just on wood-paneled walls, red alder pantry-style cabinets, and a bronze stained floor. There are also wall-mounted racks for golf and ski gear, and a lift system to keep his Heritage Harley-Davidson motorcycle off the floor.

Lawyer Bob Wade spent about $275,000 to build an unassuming 2,400-square-foot cedar garage at the foot of his driveway in Northampton County in eastern Pennsylvania. But inside, it's more like a museum to house his collection of six classic cars, including a 1965 Porsche Cabriolet. The space features a 130-square-foot work area and a hydraulic car lift. It even has a shower so Wade can clean up when he's finished working on the cars.

RICHARD FREEDA/AURORA

Where the Rubber Leaves The Road

Bob Wade's 2,400-square-foot temple to his six classic cars (facing and left) includes a hydraulic lift for serious tinkering and a shower for when the work is done.

Increasingly, though, owners are revamping their garages, or at least part of them, into livable spaces where they can spend time on everything from hobbies to hosting wine tastings. Zev Pomerance, who owns garage outfitter Potomac Garage in Gaithersburg, Md., says his clients want to spiff up the garage because it's the real gateway to the home. "Neighbors, friends, family—they all enter the house from the garage," he says.

A lot of people keep an extra refrigerator in the garage. Now, entire kitchens are sharing space with the Volvo and Harley. Dan Lajoie, who runs Gourmet Garages in Wallingford, Conn., says he's currently designing a garage for a doctor who loves to cook. It includes a butcher-block food prep area and storage for pots and pans.

In a few weeks, Michael Cardenas, who owns eight restaurants in Los Angeles and Las Vegas, will be moving his 2,000-bottle wine collection from a spare bedroom in his Malibu (Calif.) home to a new temperature-controlled wine cellar in the garage he's having renovated. The project, which cost around $35,000, also includes cabinets for storing pans, plates, linens, and other catering supplies.

If you would like to create your own über-garage, start by checking out Bill West's *Your Garagenous Zone: Innovative Ideas for the Garage.* The book includes architectural layouts for garages that can "enhance the appearance of the home" without it being the first, biggest thing you see when you look at the house. There's also a section on garage-appropriate materials and accessories, such as flooring and shelves, with information on the companies that sell them.

A fridge in the garage is standard, but have you considered a kitchen?

Auto buffs should pick up Richard Newton's *Ultimate Garage Handbook.* Companies such as GarageTek, The Complete Garage, or Garage Envy specialize in refurbishing garages with cabinets and storage systems, lighting, and epoxy or tile flooring. You can buy the products and do it yourself, or the companies can arrange for installation. For the really big project, you may want to hire an architect and contractor.

It's one thing to equip your current garage with such showstoppers as marble countertops, skylights, and humidity controls. But if you want to build o pand a garage so it's more like an ex sion of your living space, be sur check the local zoning laws. In c neighborhoods, you may be thwarte rules that limit the amount of s structures can occupy to 50% or le the lot size. If you wa build up instead of o say, to add an in-law ap ment above the gara you may encounter li on the number of resi tial units allowed in a zoned for single-fa dwellings. Another is warns John Connell, a chitect in Warren, Vt., es if your plans inclu built-in automotive li pit. It will raise buildin spectors' concerns about the dispos oil or other hazardous substances can cause environmental problems.

Of course, if everything you want in your garage adds up to more s than you can legally create, you al have an easy way to get better use your existing garage. Just park your c the driveway.

Garage Dreams

Here are some companies that can help plan and equip your space:

DESIGNS ONLY

Archway Press
archwaypress.com
800 374-4766

Garage Plans Center
garageplanscenter.com
800 210-6776

DESIGNS AND STORAGE SYSTEMS

Garage Envy
GarageEnvy.com
888 249-1766

Gourmet Garages
gourmetgaragesct.com
203 494-8740

Paragon Garage Co.
GarageZ.com
866-8GARAGE

Potomac Garage Solutions
potomacgaragesolutions.com
240 361-1800

The Garage Shop
tameyourdomain.com
262 782-2890

STOW AND GO David Rodrigues' Harley doesn't eat into his four-car garage

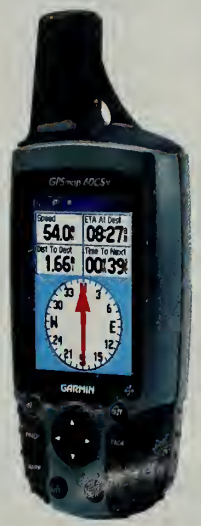
Envy of the Explorers Club

Pocket GPS devices don't just navigate anymore. BY ANDREW PARK

GPS DEVICES HAVE long helped outdoors enthusiasts steer through the woods or mark prime fishing spots, but their dull designs were more practical than fun. Now improvements in technology are bringing forth do-everything gadgets with bright screens, loads of memory, and high-performance receivers that give fast and accurate readings, even when shrouded by trees.

I recently tested four top-of-the-line models to see which were worth taking into the wild. Three had color displays, electronic compasses, and barometric altimeters for tracking elevation and predicting weather, as well as memory card slots for adding detailed topographical or marine maps. While I drove, they all could identify points of interest, highway exits, and restaurants. The fourth, a fitness-friendly wrist device, uses GPS to enhance outdoor workouts.

Once home, users can easily download details of excursions to a PC. Or share them with other outdoor freaks on Web sites such as Garmin's Motion-Based, which has nearly a half-million hikes, runs, bike rides, and other adventures posted by its members.



▲ **Garmin** offers a wrist gadget that would make Dick Tracy drool. The **Forerunner 305** (about $350 online) lets runners, bikers, or walkers map out their workouts and then track position, pace, heart rate, and other performance data as they train. Afterward they can use the accompanying software to analyze whether the course unleashed their inner Ironman.

◀ The **Garmin GPSMap 60CSx** ($450-$500 online) was the peak performer. It took less than 30 seconds to fix my position after I hit the power button, compared with nearly a minute for the competing models I tested.

▶ Take along your tunes. The **Lowrance Electronics iFinder Expedition C** (about $280 online) lets you listen to MP3s. I also could record my thoughts about the trek through a built-in microphone.

◀ **Magellan eXplorist XL** ($350-$400 online) has a display that's 77% bigger than Garmin's 60CSx. But the eXplorist weighs 12.25 ounces, nearly 5 ounces more. The 5.4-ounce eXplorist 500 (about $250) has the XL's easy-to-use joystick and clear color screen, plus a waterproof case and rechargeable battery.

BusinessWeek online To see many of these portable GPS units in action, go to businessweek.com/go/tv/gps

BY ROBERT PARKER

Spanish Reds, Incomparable Value

A 90-POINT WINE FOR $7? You can find that kind of value in Spanish wines nowadays. That's because, in recent decades, many growers and vintners have successfully adopted modern viticultural and winemaking practices. A for current vintages, 2004 is an exceptional year, and 2005 is impressive as well. The only year to avoid is 2002, though there are exceptions. Last week we offered white and sparkling wines. This week, we recommend some red

Bodegas y Vinedos del Jalón 2004 Viña Alarba Old Vines
90 points. It boasts a deep ruby/purple color, full body, and wonderful kirsch liqueur and raspberry aromas and flavors interwoven with hints of licorice as well as minerals. This stunning effort is almost too good to be true. Drink it over the next one to three years. $7

Finca Luzon 2004 Luzon
90 points. A blend of 65% monastrell (better known by its French name, mourvèdre) and 35% syrah. It is a full-throttle, exuberant, dense ruby/purple-colored effort with loads of crème de cassis, licorice, truffle, and acacia flower characteristics. This exotic, deep, broad, intense red should be drunk over the next three to four years, although it may last longer. $8

Bodegas Mas Que Vinos 2003 Ercavio Roble
91 points. Made entirely from cencibel (the local term for tempranillo), it smells like a great Napa cabernet sauvignon. Gorgeous blueberry liqueur notes intermixed with graphite and minerals jump from the glass of this dark ruby/purple-colored wine. It boasts fabulous intensity, an alluring texture, and a rich, concentrated finish with no hard edges. It could easily compete with wines selling at four to five times the price. Drink it over the next three to four years. $10

Senorio de Barahonda 2004 Monastrell Tinto
90 points. An extraordinary bouquet of raspberries, blueberries, and vanilla jumps from the glass of this dense, medium- to f bodied, luscious, fruit-filled, seamlessly constructed effort. It is ideal for consumpt over the next several years. The good news that 2,500 cases have been exported to th U.S. $10

Celler de Capçanes 2003 Mas Dc Barrica
92 points. Aged 10 months in both America and French oak. Its dense ruby/purple color followed by sumptuous aromas of blueberri black currants, cold steel, and minerals. It h an amazing fragrance, considerable nobility well as complexity, medium to full body, and long, concentrated, heady finish. Enjoy it ov the next five to seven years. $12

Bodegas Castaño 2003 Solanera
91 points. A dense ruby/purple color wine a smoky, scorched earth-scented nose an displays of black cherry jam, licorice, and truffles. Ripe and medium- to full-bodied v wonderful sweetness, it possesses purity, suppleness, and balance. Enjoy it over the next two to three years. $15 ■

Visit **www.eRobertParker.com** for the Internet's most active wine bulletin boa tens of thousands of tasting notes, or t order his recent book, *The World's Greatest Wine Estates: A Modern Perspective*. You can also subscribe to Parker's newsletter, *The Wine Advocate* Request a sample copy at: *The Wine Advocate*, P.O. Box 311, Monkton, MD 21

Wines rated from 96-100 are extraordinary; 90-95, excellent; 80-89, above average to very good. For more Parker picks, go to businessweek.com/e

ITED BY MONICA GAGNIER

D OAK

ASHING IN ON HE BARREL HEAD

N PAUL BLOCK looks at an old oak barrel, he sees tables, rocking chairs, serving pieces with elegant lines and tifully polished finishes. From his stoga (Calif.) workshop, built with—t else?—wine barrels, he produces roducts, from a $40 sushi tray to a 00 display case. Block, a sculptor former chef, is passionate about the lescence" of the wine-stained oak. platters and other small items are ale at two nearby wineries, as well specialty retailer Dean & Deluca's es and catalog. He sells bigger es through his Web site, ebarrelfurniture.com. *–Moira Herbst*

CYCLED Block's barrel furniture

AVORS

NEW SPIN ON EANUT BUTTER

ATOGA SPRINGS, N.Y., is known for eral water, battlefields, and oughbreds. (The racing season starts 26.) But Jessica Arceri and Chris er hope it will be equally famous for ored peanut butters, such as Blizzard ter (white chocolate), Chill'n colate (chunky dark), and Monkey (banana with raisins). Launched in 5, **Saratoga Peanut Butter** ($5 to $6 a has been a hit at farmers' markets gourmet shops. It's also available ne (saratogapeanutbutterco.com). *–Tom Dowd*

TIME OFF

The Spa, 'Starbucked'

CAN A PURVEYOR of colorful women's clothing make the leap into high-end day spas for both sexes? Coldwater Creek, probably best known for its catalog, is testing spas in six markets where it has retail stores. Decorated with earth tones and natural woods, the new spas avoid the kind of feminine decor that might scare away male customers. "Nobody has Starbucked the day spa experience," says Dan Griesemer, executive vice-president of sales and marketing.

So far, Coldwater Creek has opened locations in upscale shopping areas in Chicago, Dallas, Denver, Los Angeles, and the Portland (Ore.) suburbs. A sixth, near San Francisco, is expected to open by late August, and at least 10 more are on tap for 2007. The staff includes veterans from two well-known destination spas: The Greenhouse in Dallas and Connecticut's Spa at Norwich Inn.

Prices for services vary slightly by market. At the spa in Southlake Town Square, an outdoor mall near Dallas, the Hot River Stone massage is $165 for 90 minutes, while the Skin Therapy for Men facial is $100 for an hour. *–Lauren Young*

GOLF 911

FOR ALL THOSE TIMES you get to the course and realize—drat!—your golf shoes are at home, Rede Golf has an answer: adhesive-backed cleats that convert any shoes into a pair acceptable for a round. Simply peel the plastic off each of the cleats (which come in the shape of a "red E"—get it?) and press them firmly onto your soles. After your round, run a knife under the cleats to pop them off ($20 for 20 cleats; redegolf.com). *–Dean Foust*

The Best E-Broker For You

The price of a trade is just the start. Here's what you need to know to choose wisely. **BY LEWIS BRAHAM**

WHEN A BANK GETS GOBBLED up by a competitor, customers often end up paying higher fees and are required to keep bigger balances. Airline mergers usually result in higher fares and fewer flights. But so far the consolidation among online brokerages hasn't been too hard on customers. According to Needham (Mass.) research firm Tower Group, the business has shrunk from 154 players in 2000 to about 60 today. Yet for some customers, fees are down. Clients of the former TD Waterhouse, now TD Ameritrade, pay stock-trading commissions of $9.99 instead of as much as $17.95 before. Other investors are being offered a wider range of services. Customers of Brown & Co. and Harris Direct, both acquired by E*Trade, now also have access to bank accounts, home mortgages, and financial advice.

Indeed, there's still plenty of competition among the remaining online brokers, and new ones, such as Sogoinvest, joined the crowd just days ago. Want to compare commissions? Rates on margin loans? Costs to invest in mutual funds? They're all in the table on page 64, along with results from the most recent J.D. Power & Associates rankings of overall customer satisfaction, which are based on customer surveys. (J.D. Power, like *BusinessWeek*, is a unit of The McGraw-Hill Companies.)

Who's the best to do business with? That depends on what you want from a broker. Do you value cheap commissions, fastest order execution, or the biggest menu of mutual funds? Or maybe you don't have a strong preference and just want an e-broker that does an all-around top job.

OVERALL SERVICE Perhaps the best broker for the money is Scottrade, where a stock trade costs just $7, period. Many brol have tiered pricing that rewards ac traders or wealthier investors with lo rates. And even the cheapest brokers ten charge a penny or two a share w an order is more than 1,000 or 2,(shares. Scottrade charges only $17 f mutual fund trade, vs. $35 at m brokerages. Those trades are free if t involve one of Scottrade's 893 no-tra action-fee (NTF) funds.

Still, what gives the company an e over even lower-cost competitors is 272-branch network, with offices in states. If you're having any kind of pr lem, instead of waiting to reach a center, you can drop into an office. "I personal relationship with our rep very important to our customers," s Chief Executive Rodger Riney.

The combination of low cost and e service has earned Scottrade the Power customer satisfaction award six years in a row. Moreover, CEO Ri is adamant about bucking the indust consolidation wave and keeping S trade independent. Because the c pany is private, Riney is under no p

Scottrade's 272 offices in 47 states mean you can dro

from public shareholders to do erwise.

UAL FUND INVESTING Firstrade charges 05 a pop for all stock trades. But it ges nothing to trade mutual funds. t includes offerings from such low- fund families as Vanguard and T. e Price that almost never wind up in kers' no-transaction-fee programs be- se they won't pay the fees those pro- ns require.

lhinkorswim, a broker that offers 05 stock trades, also charges nothing fund trades as long as you don't make e than three per month. Beyond that charge is $15 per transaction.

*Trade provides another perk to fund stors. For funds that levy marketing on shareholders known as "12(b)-1 ," the brokerage will rebate half that unt to investors in those funds.

ICE INVESTORS At ShareBuilder, "you literally open an account with $10," CEO Jeffrey Seely. No minimum in- ment, no extra account fees. Share- der's automatic-investing program is great for a newbie's savings discipline. For $20 a month you can make 20 automatic stock or exchange-traded fund (ETF) purchases. For $12 a month you get six trades. The drawback: Sharebuilder generally places all of its automatic trades just once a week, on Tuesday mornings. That might be fine for someone who's accumulating stocks and planning to hold them for a long time. But if you'd rather have your order filled immediately, it can cost as much as $15.95. In that case, a better option may be the just-launched Sogoinvest.com, which has a similar automatic-investment plan that charges just $3 for real-time trades.

ACTIVE INVESTORS Talk about cheap: At Interactive Brokers, a stock trade costs 0.5¢ a share, with a minimum of $1 a trade. That's below what most institutional investors pay. The catch is that the firm charges a $10 monthly maintenance fee if you don't spend at least $10 trading. But for many investors, the $120 minimum annual cost is well worth it. According to the J.D. Power survey, the average online investor made 36 trades in 2005, up from 23 in 2003. Even at Scottrade, 36 trades amounts to $252 a year, more than double Interactive Brokers' $120.

For active investors, the margin rate—what it costs to borrow from the broker to leverage your holdings or sell stocks short—may also be an important factor. Every broker has a tiered pricing system for margin loans, with larger amounts getting the best rates. Here again, Interactive Brokers has the best deal: just 7% for borrowings of $100,000 or less and as low as 5.5% for $3 million or more.

BREADTH OF PRODUCT If you want one-stop shopping for your entire financial life, you're better off with Charles Schwab or E*Trade, where you can have your bank account, mortgage loans, insurance, estate planning, and financial advice all in one place. The advantages: one statement instead of many, simpler data collection at tax time, and an easier way to develop a comprehensive financial plan.

ONLINE RESEARCH For depth of research, Fidelity Investments is tops with its vast array of analysis and investment tools. The research comes from 13 firms from big names, like Lehman Bros. and Standard & Poor's (like *BusinessWeek*, a unit of The McGraw-Hill Companies) to the lesser known, like Channel Trend, a stock-rating service.

Schwab's research is not as diverse, but it does have a proprietary stock-rating system that has trounced the Standard & Poor's 500-stock index since its May, 2002, introduction. Merrill Lynch Direct's research is proprietary, too, produced by one of the world's largest investment research teams.

YIELD A few years ago, when interest rates were lower, no one would have taken note of the rate a broker paid on cash balances. But now, with short-term rates more than four percentage points higher, yield can influence where you choose to take your business. A yield difference of just one or two percentage points can amount to thousands of dollars a year depending on the amount of cash you have in your account. Idle cash in Vanguard Brokerage Services automatically goes into the Vanguard Prime Money Market Fund, which currently earns 5%, making it about the most attractive deal around. With a

h a problem instead of waiting on hold for a call center

$5 million balance, the yield is 5.2%.

Other brokers have a tiered interest rate system that depends on your account size. On balances of $10,000 or more, for example, Interactive Brokers pays 4.8%. Accounts with less than $10,000 earn nothing. At Scottrade, $1 million accounts get a 4.3% yield, while those with under $1,000 earn only 1.8%.

Whichever broker you choose, ask about how cash is treated. At Muriel Siebert, T. Rowe Price, and Vanguard, for instance, cash automatically goes to a money market fund. At others, such as Schwab, E*Trade, and TD Ameritrade, you need to specifically instruct the firm to sweep your cash into a money market fund. Otherwise it will sit in a cash account, with the yield determined by the firm, not the market. Those yields may be only around 1%.

TRADE EXECUTION If you want 1,000 shares of a stock currently trading from $10 to $10.05 a share on the New York Stock Exchange, does your broker get them for you at $10, $10.05, or somewhere in between? The answer can cost or save you a lot more than the commission you paid.

Yet determining the quality of a broker's execution isn't easy. It took CEO Alan Shapiro of Transaction Auditing Group (TAG), an execution-tracking firm, two full days to gather data on and analyze the brokers in our table.

One key execution statistic, Shapiro says, is price improvement, which means getting a better price than the best bid (the price a broker will give you if you're selling shares) or the offer (the asking price if you're a buyer) on an exchange-listed stock. In the previous example, a broker who is able to get shares of the stock for $9.99 for a buyer or $10.06 for a seller would be improving the price by one penny. Not a lot, but if you trade enough and in large enough quantities, it adds

Another stat to conside the fill rate for limit orde those for which you set a p to buy or to sell, and the tr is made only if the pric met. Then there's speed. you have to wait more tha seconds to get your shares you did, the stock may r cost $10.15 instead of $10.

By those standards, Schv offered investors the l execution in NASDAQ-lis stocks during the first qua of this year, according to T For regular or "market orders," Schv gave investors price improvement 62% of their trades, vs. 41% for the av age broker in the group. The firm had a 75.4% fill rate for limit orders executed 98% of its trades in less tha seconds, compared with just 53% 94%, respectively, for the average fi For NYSE-listed stocks, Firstrade Scottrade were better at improv prices for their customers.

BusinessWeek weekend For more on online brokerages, watch BusinessWeek Weekend. Check local listings or see segments at businessweekend.com

How the Web Brokers Stack Up

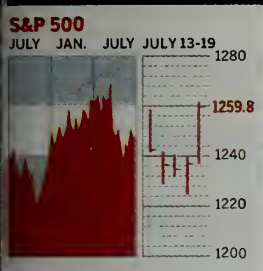
BROKER/ WEB SITE	STOCK TRADE PRICE RANGE	MUTUAL FUND ORDER*	PRICE IMPROVEMENT %***	LIMIT ORDER FILL RATE***	YIELDS ON CASH†	HIGHEST MARGIN RATE†	OVERALL CUSTOMER SATISFACTION††
Charles Schwab schwab.com	$9.95–$12.95	$49.95/NTFs	61.6%	75.4%	1.0–5.0%	10.75%	**5th**
E*Trade Financial etrade.com	6.99–12.99	19.99/NTFs	45.9	42.9	0.2–4.7	10.24	**8th**
Fidelity Investments fidelity.com	8.00–19.95	75.00/NTFs	31.6	60.0	3.2–5.1	11.08	**3rd**
Firstrade firstrade.com	6.95	Free	62.1	61.7	2.3–4.2	9.75	**N/A**
Interactive Brokers interactivebrokers.com	1.00–5.00	No funds	17.9	28.0	0.0–5.0	6.97	**N/A**
Merrill Lynch mldirect.com	29.95	NTFs	22.4	65.2	1.5–5.0	11.63	**N/A**
Muriel Siebert murielsiebert.com	14.95	35.00/NTFs	29.9	57.0	4.5–4.8	9.00	**N/A**
OptionsXpress optionsxpress.com	9.95–14.95	14.95	27.4	50.9	4.0	8.75	**N/A**
Scottrade scottrade.com	7.00	17.00/NTFs	56.6	50.6	1.8–4.3	10.50	**1st**
Sharebuilder sharebuilder.com	1.00–15.95	No funds	50.4	47.9	4.6	None	**4th**
TD Ameritrade tdameritrade.com	9.99	49.99/NTFs	59.8	44.0	0.3–4.3	11.00	**6th/7th**
thinkorswim thinkorswim.com	5.00–9.95	Free**	24.8	49.9	1.5–3.8	8.95	**N/A**
Trade King tradeking.com	4.95	14.95	N/A	N/A	1.0–4.3	8.00	**N/A**
T. Rowe Price Brokerage troweprice.com	12.95–19.95	35.00/NTFs	46.2	56.9	4.3–4.8	10.50	**N/A**
Vanguard Brokerage Services vanguard.com	8.00–25.00	35.00/NTFs	38.6	50.9	4.6–5.2	10.00	**2nd**

* NTF indicates broker offers no-transaction-fee funds. Costs are for funds not in the NTF program.
**Allows three free trades per month, after which it charges $15 per trade.
*** For orders of 100 to 500 shares of NASDAQ-listed stocks from Dec. 31, 2005, to Mar. 31, 2006.
† As of July 17
†† Based on J.D. Power & Associates' 2005 survey, which was prior to the merger of TD Waterhouse and Ameritrad

Data: J.D. Power & Associates, Transaction Auditing Group, brok

gures of the Week

OCKS



MMENTARY

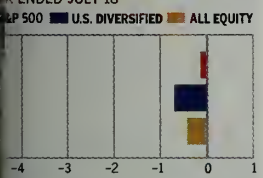
Dow surged 212 points on 19—its most mirthful day of year—after Federal Reserve rman Ben S. Bernanke ed that two years of rate s could soon end. It was ome news after higher oil es, a slowing housing ket, weaker corporate profits another war in the Middle rattled the markets. Most ces ended the week flat.

Bloomberg Financial Markets, Reuters

UTUAL FUNDS

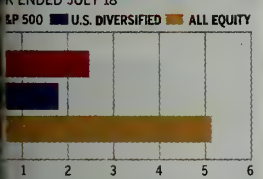
EEK TOTAL RETURN

K ENDED JULY 18



WEEK TOTAL RETURN

K ENDED JULY 18



Standard & Poor's

U.S. MARKETS

	JULY 19	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1259.8	0.1	0.9	2.5
Dow Jones Industrials	11,011.4	0.0	2.7	3.4
NASDAQ Composite	2080.7	-0.5	-5.7	-4.3
S&P MidCap 400	740.2	-0.8	0.3	3.9
S&P SmallCap 600	364.1	-0.5	3.8	4.8
DJ Wilshire 5000	12,642.8	0.0	1.2	3.1

SECTORS

BusinessWeek 50*	706.1	-0.3	-4.8	-3.1
BW Info Tech 100**	361.8	-1.1	-4.9	-2.6
S&P/Citigroup Growth	580.5	0.1	-2.7	-1.6
S&P/Citigroup Value	677.9	0.1	4.7	6.8
S&P Energy	425.3	-1.3	14.1	20.0
S&P Financials	437.7	1.1	2.6	8.3
S&P REIT	174.1	0.3	13.8	12.2
S&P Transportation	273.0	-0.1	9.3	29.0
S&P Utilities	168.6	1.7	5.6	3.7
GSTI Internet	158.9	-3.8	-22.6	-7.3
PSE Technology	756.6	-0.4	-9.5	-5.2

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS

	JULY 19	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1621.4	-2.8	7.3	16.9
London (FT-SE 100)	5778.0	-1.4	2.8	11.1
Paris (CAC 40)	4846.5	-1.9	2.8	9.5
Frankfurt (DAX)	5539.3	-1.7	2.4	16.1
Tokyo (NIKKEI 225)	14,500.3	-4.9	-10.0	23.3
Hong Kong (Hang Seng)	16,097.5	-2.6	8.2	10.5
Toronto (S&P/TSX Composite)	11,619.6	-1.3	3.1	13.2
Mexico City (IPC)	19,871.8	2.3	11.6	40.3

FUNDAMENTALS

	JULY 18	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.92%	1.86%	2.00%
S&P 500 P/E Ratio (Trailing 12 mos.)	16.5	17.0	19.4
S&P 500 P/E Ratio (Next 12 mos.)*	13.5	13.9	15.5
First Call Earnings Surprise*	3.80%	8.63%	3.22%

*First Call Corp.

TECHNICAL INDICATORS

	JULY 18	WEEK AGO	READING
S&P 500 200-day average	1264.5	1263.7	Positive
Stocks above 200-day average	41.0%	55.0%	Neutral
Options: Put/call ratio	1.08	0.85	Positive
Insiders: Vickers NYSE Sell/buy ratio	2.57	2.48	Negative

BEST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
Fertilizers & Ag. Chems.	14.1	Steel	99.4
Integrated Oil & Gas	13.1	Agricultural Products	92.3
Managed Health Care	11.6	Divsfd. Metals & Mining	58.2
Home Entertainment	11.5	Oil & Gas Equipment	50.7
Oil & Gas Refining	11.4	Constr. & Engineering	50.0

WORST-PERFORMING GROUPS

	LAST MONTH %		LAST 12 MONTHS %
IT Consulting	-16.6	Homebuilding	-44.2
Trading Cos. & Distribs.	-13.0	Tires & Rubber	-41.4
Comptr. Stge. & Perphs.	-12.8	Educational Services	-32.0
Home Furnishings Retail	-12.4	Automobiles	-32.0
Employment Services	-11.6	Home Furnishings Retail	-29.6

EQUITY FUND CATEGORIES

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Latin America	8.2	Precious Metals	66.1
Precious Metals	7.1	Latin America	43.0
Natural Resources	6.2	Natural Resources	25.1
Real Estate	4.4	Diversified Emrg. Mkts.	24.9
LAGGARDS		LAGGARDS	
Technology	-4.6	Technology	-5.3
Japan	-4.3	Large-cap Growth	-1.5
Communications	-1.9	Health	-1.4
Small-cap Growth	-1.7	Small-cap Growth	0.4

EQUITY FUNDS

4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
ProFunds Oil & Gas Inv.	16.0	U.S. Global Invrs. Gold	102.2
DireXion L. Am. Bl. 2X Inv.	14.4	Midas	95.9
streetTRACKS Gold Trust	13.7	U.S. Glbl. Invs. Prc. Mnls.	91.0
DireXion NASDAQ 100 Br. 2.5X Inv.	12.7	Van Eck Invrs. Gold A.	84.2
LAGGARDS		LAGGARDS	
ING Intl. Port S2	-16.3	Ameritor Investment	-75
DireXion NASDAQ 100 Bl. 2.5X Inv.	-13.6	American Heritage Growth	-33.3
American Heritage	-12.5	ProFunds. Semicdr. Inv.	-31.2
Kopp Emerg Gr. A	-11.9	Alpine U.S. Rl. Est. Eq. Y	-28.4

INTEREST RATES

KEY RATES	JULY 19	WEEK AGO	YEAR AGO
Money Market Funds	4.75%	4.74%	2.80%
90-Day Treasury Bills	5.11	5.07	3.30
2-Year Treasury Notes	5.11	5.17	3.86
10-Year Treasury Notes	5.06	5.10	4.18
30-Year Treasury Bonds	5.10	5.14	4.42
30-Year Fixed Mortgage †	6.71	6.70	5.65

†BanxQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	4.17%	4.53%
Taxable Equivalent	5.96	6.47
Insured Revenue Bonds	4.22	6.03
Taxable Equivalent	4.62	6.60

THE WEEK AHEAD

XTING HOME SALES *Tuesday, L 25, 10 a.m., EDT* » x ing home sales in June are cted to have eased to an nial rate of 6.6 million units, 6.67 million in May. That's the ian forecast of economists eyed by Action Economics.

OSUMER CONFIDENCE *sday, July 25, 10 a.m., T* » The Conference Board's u consumer confidence index k eased to 104.9, from 105.7.

BEIGE BOOK *Wednesday, July 26, 2 p.m. EDT* » The Federal Reserve issues its overview of economic activity ahead of the Aug. 8 monetary policy meeting. Most economists polled by Action Economics expect the Fed to hold interest rates at 5.25%.

NEW HOME SALES *Thursday July 27, 10 a.m. EDT* » June new home sales probably cooled to an annual pace of 1.2 million units, from 1.23 million in May.

GROSS DOMESTIC PRODUCT *Friday, July 28, 8:30 a.m., EDT* » Second-quarter real gross domestic product is forecast to have grown at an annualized rate of 3.1%, following a 5.6% jump in growth during the first quarter.

EMPLOYMENT COST INDEX *Friday, July 28, 8:30 a.m., EDT* » Compensation most likely increased 0.9% in the second quarter, after a 0.6% rise during the prior period.

The *BusinessWeek* production index rose to 283 for the week ended July 8 and stood 13% above the previous-year reading. Before calculation of the four-week moving average, the index climbed to 287.8.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras

BY GENE G. MARCIAL

SOARING ENERGY PRICES ARE BUOYING CONOCOPHILLIPS.

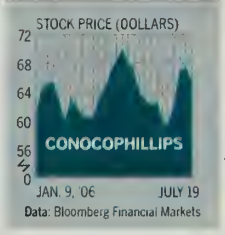
A KNOCKDOWN GENENTECH DOESN'T REALLY DESERVE.

WHY A GIANT BANK MAY TAKE AIM AT FIRST HORIZON NATIONAL.

ConocoPhillips: Surging

THE WORSENING MIDDLE EAST CRISIS has driven oil prices up to recent highs of more than $76 a barrel. And the surge "is far from over, making energy stocks even more compelling," says Stephen Leeb of Leeb Capital Management, a long-term oil bull. *The Oil Factor*, a book he wrote in 2004 when oil was at $33, predicted that soaring energy prices were just around the corner. Today, Leeb's No. 1 pick is ConocoPhillips (COP), the third-largest U.S. integrated energy company and biggest refiner, in which Warren Buffett is a top investor. This spring, Berkshire Hathaway bought $1.1 billion in Conoco stock, for a 2% stake. Yet Conoco remains undervalued, argues Leeb, who owns shares. That's partly because some analysts think it paid too much when it bought Burlington Northern for $35 billion in March. Leeb disagrees. The purchase is a bet on natural gas and will be a plus, he says. Don Schreiber, president of WBI Investments, which also owns shares, says the stock is cheap at 65.77, roughly six times estimated 2006 earnings. On July 14, Conoco reported it had found oil in Alaska's North Slope. Based on revenue and earnings prospects, the stock is worth 85, figures Schreiber. Tina Vital of Standard & Poor's, who rates the stock a "buy," says Conoco's recent purchase of a 17% stake in Russia's Lukoil could boost its reserves by 10%. And its reentry into Libya "should raise its output at an attractive cost," she adds. Vital rates Conoco a "buy." She expects it to earn $10.06 a share this year and $10.68 in 2007.

PUMPED AGAIN

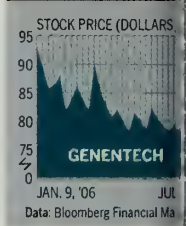


Data: Bloomberg Financial Markets

Genentech Is More Robust Than It Looks

GENENTECH (DNA), THE WORLD'S second-largest biotech and an innovative developer of biotherapeutics, gets no favors from the Street. Its stock slipped from 84.06 to 81.56 on July 11 even though it had just posted an 80% jump in second-quarter earnings. Now it's at 79.30. The rap: The $423 million sales of its Avastin colon cancer drug were 4% below consensus estimates. Never mind that this was a 72% jump in sales or that Genentech's two other major drugs beat forecasts. Sales of Rituxan, for non-Hodgkin's Lymphoma, rose 17%, to $526 million, and those of Herceptin, for breast cancer, more than doubled, to $320 million. Some bulls see the stock's drop as a chance to buy. Geoffrey Porges of Sanford C. Bernstein upgraded it from "hold" to "outperform," with a 12-month target of 98. He says Genentech can deliver annual profit growth averaging 28% between 2005 and 2010. He expects earnings to jump to $2.51 a share in 2007, up from $1.85 this year. Kavita Thomas of First Global Markets also upped Genentech to "outperform." Herceptin's expected approval in August early-stage breast cancer, and the wider use of Avastin for r small-cell lung cancer, are both good signs, she says.

ANOTHER RECENT SLIP



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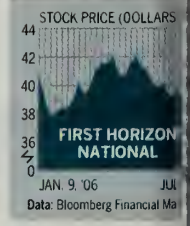
A Sitting Duck In Memphis?

FIRST HORIZON NATIONAL (FHN), a $37 billion banl holding company in Memphis that operates in 30 sta may be ripe for a buyout. So says Jacqueline Reeves, managing director at investment bank Ryan Beck, who expects little bounce in earnings because of the slowing ho mortgage business. "Margins are under pressure," she notes. Reeves forecasts nearly flat earnings of $3.35 a share in 2006 and $3.55 in 2007, vs. $3.40 in 2005. In a buyout, she figures the stock, now at 40.34, would be valued in the low 50s. A biggie such as Wells Fargo could use its scale to run FHN more profitably, says Reeves. FHN's strong core deposits and its mortgage and capital markets businesses are part of its attractiveness to a bigger bank, she adds. Theresa Brophy of Value Line says the bank's fee income has weakened. Poor quarterly results in March prompted her t cut her 2006 earnings estimates from $3.50 to $2.65. She advises investors to hold off buying until earnings look better." FHN and Wells Fargo both declined comment.

NOT FLYING QUITE SO HIGH



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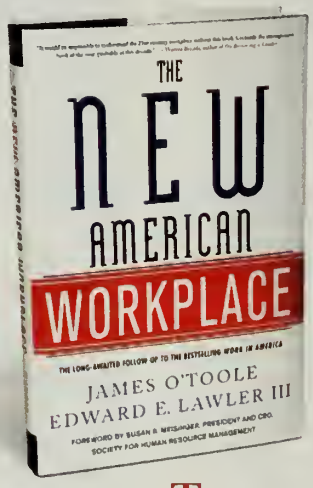
Workers as Self-Managers

THE NEW AMERICAN WORKPLACE
By James O'Toole and Edward E. Lawler III; Palgrave Macmillan; 260pp; $27.95

Three decades ago, then-Secretary of Health, Education, and Welfare Elliot L. Richardson handed a government task force the ambitious job of examining U.S. working conditions. It was a time of widespread concern about "blue-collar blues" and disaffection over stultifying, routinized jobs. After a year's study, Richardson's panel of experts produced an influential report entitled *Work in America*. It warned that too many Americans were stuck in narrow, repetitive jobs, especially in manufacturing, that lead to a variety of mental and physical health problems.



Now, 33 years later, there's a sequel from the panel's chairman, James O'Toole, a professor at the University of Southern California's Center for Effective Organizations, and his colleague Edward E. Lawler III, the center's founder and director. Their goal in *The New American Workplace* is to analyze the extensive changes that have swept through U.S. companies in the intervening years. The opening section of the book adds little to our understanding, but there follows a persuasive argument in favor of companies' adopting a high-wage, high-worker-involvement approach to global competitiveness.

The first half offers a dutiful summary of the major trends familiar to most Americans who hold a job today, from offshoring and part-time work to the end of the one-company career. One surprise: The authors find many positives where others have focused on negatives. For example, they underscore new opportunities afforded by the decline of the corporate man who spent his working life climbing the ladder at a single company. "In all, the self-directed career model offers the potential for more people to develop satisfying careers than the traditional lifetime-loyalty model did," they write. In aggregate, though, this is little more than a recap of 33 years of workplace changes. A companion volume due out in August, *America at Work* (Palgrave Macmillan, $69.95), comprising 16 studies the authors commissioned from prominent thinkers on today's workplace, may offer more new information.

O'Toole and Lawler use the second portion of their book to make the case for a "high involvement," or HI, corporate strategy—in which, for example, employees get a say in management of their own tasks and there's a strong sense of a "supportive community" at work. They argue that too many U.S. executives still treat employees as an expense rather than an asset. Most corporations, they say, take little responsibi for the social costs generated by the working conditions th offer. When employers pay wages too low to support a fam or refuse to provide health coverage, taxpayers wind up footing the bill for everything from food stamps to emerge medical care. Yet most corporate leaders believe they have choice but to pay what their rivals do—a mistake, insist O'Toole and Lawler, that has fueled a race to the bottom.

The New American Workplace maintains that rigidly adhering to the dictates of the labor market amounts to lit more than myopic leadership. Wal-Mart Stores' Sam's Clu for instance, pays less than rival Costco and offers less hea coverage. Wal-Mart, the authors contend, "has chosen to favor investors over worke when it could have chosen to meet the ne of both, as Costco does." As an alternative the pair argues for the high-involvement model. Citing Costco, United Parcel Serv and W.L. Gore, among others, they expla how HI companies offer enriching jobs a an egalitarian work culture with extensiv self-management, few layoffs, and mutu loyalty between company and employee.

While their arguments align with mai economists' views that moving up the value-added food chain is the best route global competitiveness for U.S. compani not all of O'Toole and Lawler's policy recommendations are likely to fly. Their r for boosting U.S. competitiveness with thoro educational reforms and hi in the number of college gr especially in science and m already has corporate backi But their proposals for mot nutritional and health assistance for pregnant women and universal publi preschool haven't gained widespread support.

> Too many companies still treat employees as an expense, not an asset

In their penultimate chap the authors focus on the increasingly heavy burden of choice people face, from having to decide what to study and where to work to choosing whether to join a union and when to retire. The note that *Work in America* paid little attention to issues o personal responsibility. Today, the two write, "issues of personal choice are now front-and-center whenever questions about employment policy are raised." Employe confronting this confusing state of affairs will be better o for having read this book.

– By Aaron Berns

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Ideas Outside Shot

BY CHRIS YOUNG

Hedge Funds to the Rescue

Back in the day, mergers and acquisitions advisers routinely viewed transactions as "in the bank" immediately upon the announcement of a deal. Indeed, deal conference calls were usually filled with congratulatory back-slapping from stock analysts as junior investment banking staffers planned elaborate closing dinners at tony steakhouses. True, regulatory concerns could occasionally scuttle a deal, but the shareholder vote (yawn) was usually a foregone conclusion.

But today, thanks to leadership provided by hedge fund activists, a shareholder vote can be very much in doubt. Consider the multibillion-dollar Novartis buyout of Chiron earlier this year. Chiron stockholder opposition to the buyer's "best and final" price resulted in hundreds of millions of dollars in incremental value received by target shareholders. Despite the common perception of hedgies as fast-money operators bent on corporate destruction, examples such as Chiron indicate ordinary investors can benefit from activists' "selfish" efforts.

How have we gotten here? A confluence of trends has conspired to alter the dynamics of dealmaking. First, high-profile M&A disasters like the AOL-Time Warner merger and numerous academic studies together have established a new conventional wisdom among investors that a significant percentage of deals destroy shareholder value. Even if most M&A indeed creates value, investors today will go out of their way to ensure that destructive transactions are not ratified.

Thanks to hedge fund activists, dealmakers can't rely on shareholder passivity

SECOND, HIGH-PROFILE SCANDALS of the '90s, such as Enron, WorldCom, Tyco International, and the like, have made shareholders more cynical about the decision-making process of boards of directors. Investigations into conflicts inherent in investment banking's business model have left a cloud over advisers' objectivity. (Think Jack Grubman at Salomon Smith Barney.) Fairness opinions by such experts-for-hire were finally seen for what they have been all along: nothing more than insurance policies for the board.

Lastly, investors and regulators began to pay more attention to how fiduciaries were voting shares. Today, institutional shareholders who consistently defer to management (the modus operandi of the past) may be accused of abdicating their fiduciary duties.

Only a spark was needed to ignite the new "power to the shareholders" zeitgeist. Enter the hedge funds. With their growing economic clout (an estimated $1 trillion in assets under management worldwide), they've become the catalyst for the new world order of M&A and proxy fights. Unlike their more inhibited counterparts, the so-called vanilla asset managers, hedge funds are anything but wallflowers.

To be sure, left-leaning pension funds have long taken activist stands on pet peeves such as golden parachutes or the labor impact of a proposed deal. Hedge funds, however, maintain a laser focus on shareholder value. After all, fund managers get paid 20% of any shareholder value they can "help" create. For some funds, doing the "Wall Street walk," or selling shares when things go awry, is the coward's way out. Especially during periods when markets move sideways and volatility is low, activist investing potentially provides a better path to alpha. Why wait for an investment thesis to pan out when you can accelerate the process via activist pressure?

Such thinking is even spreading to an unlikely quarter: normally quiescent asset managers. These powerful constituents have long preferred to work behind the scenes if they were unhappy and sell their shares if their concerns were not remedied. But lately, "vanilla" managers have taken the first tentative steps toward activism. In the Chiron buyout, dissidents were joined by Citibank's asset management arm, proving an imprimatur of legitimacy to the activists' cause. To the extent that other traditionally passive investors follow that lead, the power of the M&A vote to rock management's world will only increase.

So, for the time being at least, it appears that boards will have to come to terms with activists looking over their shoulders on each and every proposed deal, acting as a market check more powerful than any regulatory scheme. And yes, shareholders free-riding on the activist coattails should remember to thank the hedgies for the extra return.

CHRIS YOUNG *is a Director of M&A Research at Institutional Shareholder Services*

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Ideas The Welch Way

BY JACK AND SUZY WELCH

Outsourcing Is Forever

How can we change things in the U.S. so we don't have to outsource to India and other countries anymore?

–Anonymous, Orlando

We can't—and we shouldn't.

Look, the debate over outsourcing should be over by now. It was pretty much all about politics to begin with. The question now is not how do we stop outsourcing, but how do we use outsourcing to enhance competitiveness in what is, and forever will be, a global marketplace?

Of course, outsourcing has not been painless: Layoffs hurt. Still, they have to be seen as part of a broader picture, one in which outsourcing is not only integral to the world economy but crucial to our own growth.

Integral because economies always respond to consumer demands. People have come to expect the lowest price and the highest quality in one package. And companies can't deliver on that expectation without moving around the world to capture cost advantages and innovative minds.

As for the impact of all this on the U.S., well, it's pretty hard to criticize. Since mid-2003 the American economy has grown about 20%. That's more than $2.2 trillion—equal to the size of the total economy of China. Seven million jobs have been added. Wage growth has accelerated from 1.5% in early 1994 to more than 4% in the last year.

> The issue for the U.S. economy isn't outsourcing—it's bringing in more talent from overseas

These statistics, you can be sure, mean that outsourcing's opponents, many of whom disappeared into the woodwork even before the 2004 election, will not be out there in the 2006 campaign. Those foes had predicted American technology jobs would migrate in hordes. In fact, tech jobs have increased 17% from the pre-bubble 1999 level. No wonder most politicians now tout the overall benefits of an integrated global system.

If there is a problem with the U.S. economy right now, it is not the loss of jobs because of outsourcing. It is the shortage of skilled labor because of immigration restrictions. Indeed, if Congress really wanted to make our economy more competitive, it would raise the limits on H-1B visas, making it easier for educated foreigners to work here. Ideally, the whole program could be replaced by a permanent green card system that would draw skilled workers into a more positive, long-term relationship with the American culture—and ultimate build a better economic future for all of us.

So forget outsourcing. America's labor challenge today i talent insourcing.

I am a 29-year-old biochemist who works at a small company founded by my father 32 years ago. We haven't grown for son time, and I worry we could disappear altogether. My father a have no management experience and can't seem to make our dreams come true. Will it help if I get an MBA or update my technical knowledge?

–Marcio Luz de Oliveira Jr., Vitoria, Br

Unlikely. Your problem is too big, and time is too short. Instead, you need to accept the fact that you have reached moment-of-truth juncture in the evolution of many startup and family-run ventures. A unique technology or product, plus passion and momentum, can take you only so far. Nov you need help—from the outside.

Don't panic. Get out there and find a star CEO. Yes, that step can be an anathema for owners and entrepreneurs in your situation, but it usually hurts only at the beginning as you iron out new roles and relationships. After that, it can all upside, as newcomers, with their experience and hunge for change, find the route to growth that has eluded you.

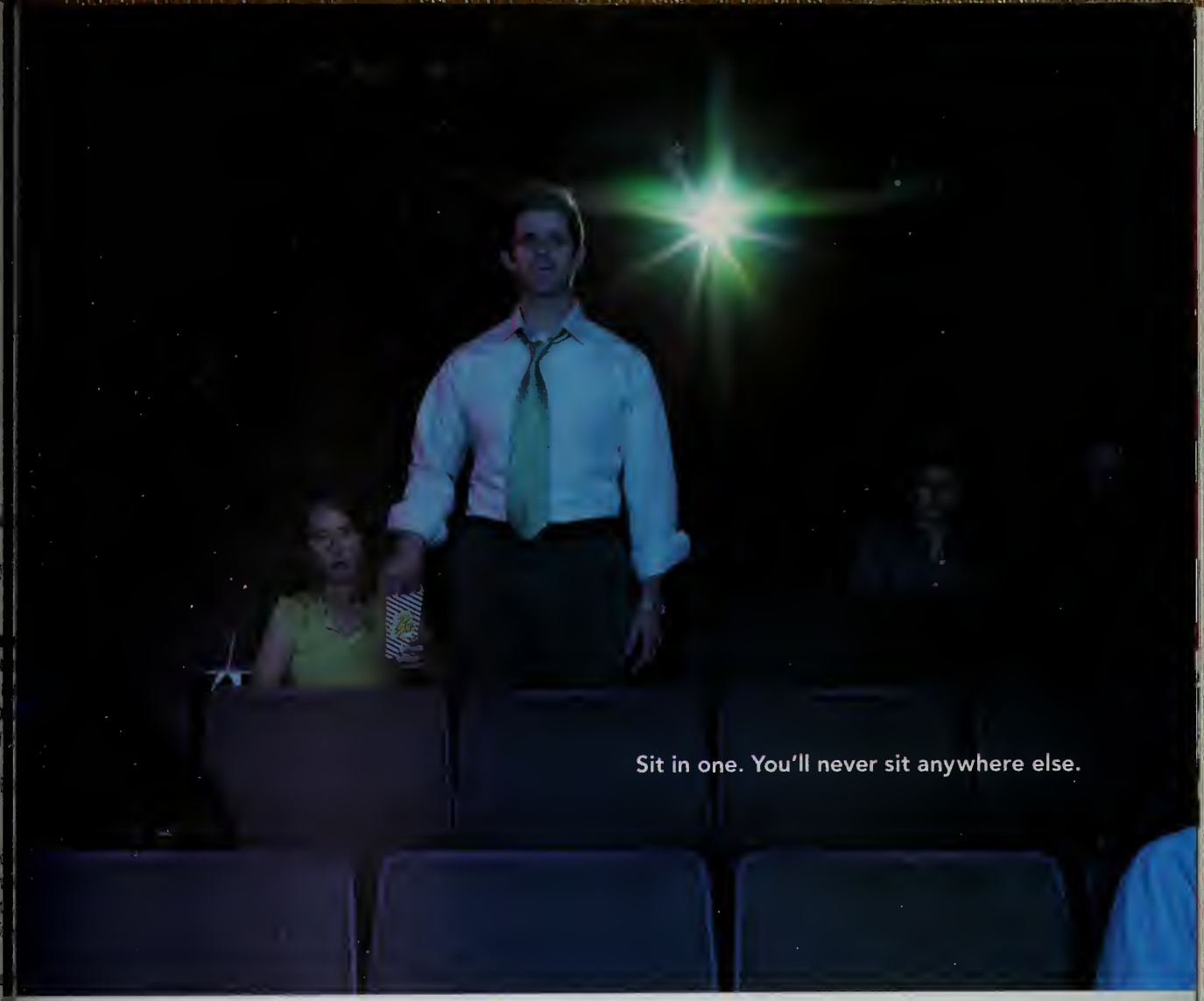
And you, incidentally, are in a particularly fortunate position. The star you need could come from your industry Big Pharma is having its own growth problems. Because o that, there are lots of talented executives who would likely jump at the chance to transform a floundering, family-operated biotech company.

Of course, to attract such a change agent, you will need give something up. You and your father, for instance, may have to let go of daily operations, hiring, and strategic planning. You will also have to let go of some equity. You simply cannot reel in a great outside CEO without giving h or her a piece of the action. The good news is, if your new does the job well, you all win, financially and otherwise, as company grows and thrives.

Yes, letting go can be scary. But there's really nothing to fear, since you and your father will retain majority control the company. Just be sure to use that control judiciously.

Remember, you hired that star executive not to obey you but to save you. ■

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at **thewelchway@businessweek.com.** *For their weekly podcast, go to www.businessweek.com/search/podcasting.htm*



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ess Week
August 7
COOLS OFF (P.32) | IBM
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BusinessWeek

006 / www.businessweek.com

Queen of Pop

et Coke's Mary Minnick.
e's blunt. She's impatient.
d she's putting the fizz
ck in a tired brand.

EAN FOUST (P.44)

» Plus
THE BEST GLOBAL BRANDS

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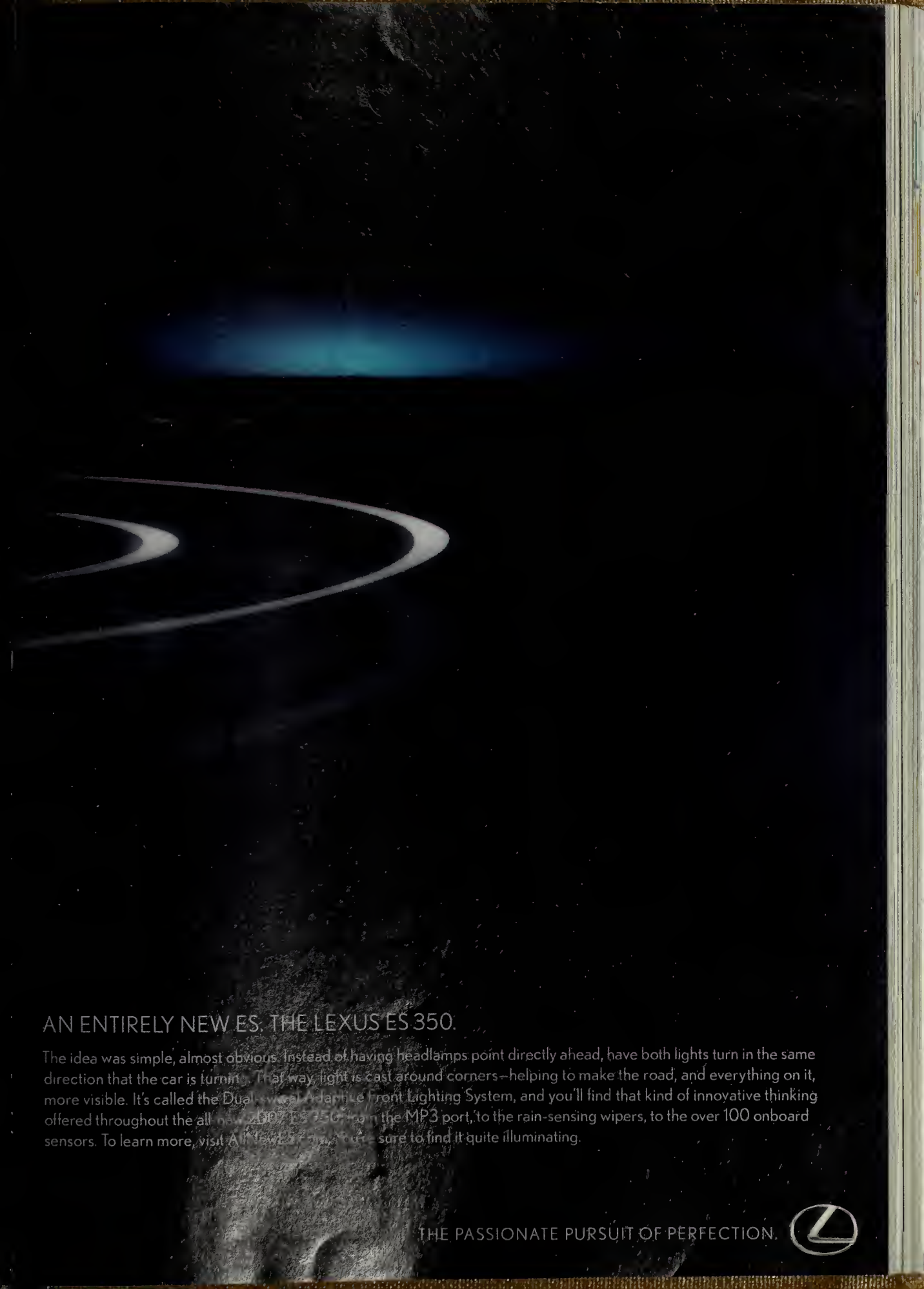
TECHNOLOGY CATCHES UP
TO COMMON SENSE.



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*Source: Morgan Stanley Capital International (MSCI) (from Factset) as of 3/31/2006.

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	1 year	5 year	10 year
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NEW Fidelity International Value Fund

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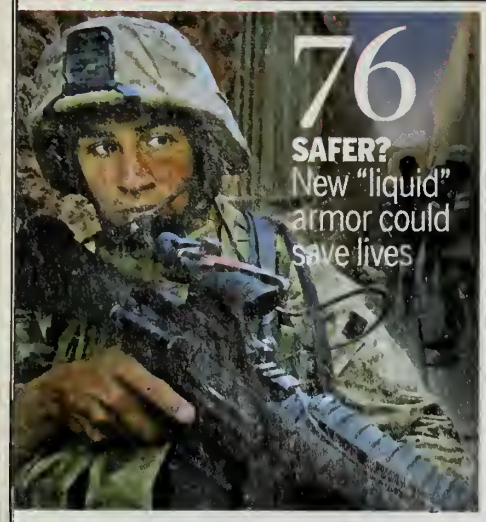

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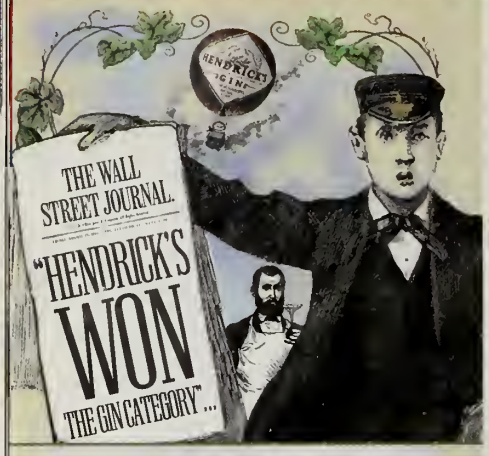

THE WALL STREET JOURNAL.

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FRIDAY, AUGUST 29, 2003 ~ VOL. CCXLII NO. 43 ~ ★★★★ $1.00

When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

LIQUOR BRAND/PRICE*	OUR AWARD
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Hendrick's $30/750ml	Most Flavorful
Tanqueray No. Ten $26/750ml	Smoothest
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From martial arts game *Project Da Ta*

Tech Prowess That's No Fantasy

In the business world, **China and India** may be best known for low-wage manufacturing and outsourcing, but they also boast dynamic and rapidly developing technology sectors. BusinessWeek.com's Special Report on the **Tech Titans** of China and India zeroes in on the trends and companies driving growth for these emerging economies. Once a telecom backwater, India is the scene of an enormous build-out of **wireless networks** that's ushering millions of the country's poor into the world of mobile telephony. We take readers inside this dramatic transformation, and hear from Qualcomm CEO Paul E. Jacobs about h company's tussle with New Delhi and telecom powerhouse Reliance. Then there's China's **online gaming craze,** particularly for interactive fantasy and combat games, a sector expected to evolve into a $2.1 billion market by decade's end. And for investors prowli around for promising India and Chine **stock plays,** Standard & Poor's provides insight into six of them. Also, check out where Intel is betting its venture capital bucks. For all this and more go to: **www.businessweek.com/go/06/titans**

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UP Front

"Yes, I'm sorry I did it."

–AOL co-founder Steve Case admitting to PBS's Charlie Rose that he regrets participating in the company's ill-fated merger with Time Warner

D BY DEBORAH STEAD

UTH DRIVE

AN GM V UP ITS P FACTOR?

LIG, Led Zeppelin. **General** t's' Cadillac division has st opped its five-year ad m ign featuring the rock n And as troubled GM tries g its brands to resonate th oung car buyers,

E OLET

d ac isn't the only line t g a marketing makeover. e mpany has just hired W ork marketing n tancy **Translation n tation & Brand Imaging** to r nd its Chevy brand with u er sounds and, perhaps, p stars.

C vy's problem is pretty a htforward. It is the GM brand with the most products priced to appeal to buyers under age 30, but its average buyer is 46. Chevy has been losing traction with young people. In 2002, almost 40% of those under age 26 said they'd consider buying a Chevy. Today, that number is down to 35%, despite three new products under $20,000—the retro-styled HHR, the economy car Aveo, and the Cobalt.

Translation Consultation has the right track record for fixing this. It hooked up Justin Timberlake with **McDonald's** and Jay-Z with **Hewlett-Packard** and **Nike.** No word on who, if anyone, might be right for Chevy. Translation CEO Steve Stoute says he's still working out how to make Chevy more relevant in urban markets on both coasts and in the South. Chevy, he says, has long been pitched as "American" in "maybe too much a red-state way." *–David Kiley*

H: BIG PICTURE

RY PAGE, SERGEY BRIN, Google

d their top exec pals at Google have d in far more cash than everyone else reporting e trades over the past two years. *–Sonja Ryst*

VE INSIDER STOCK SALES, JULY, 2004-JULY, 2006

ANY	SHARES SOLD	VALUE
gle	23.8 MILLION	$7.2 BILLION
nival	24.2 MILLION	$1.2 BILLION
ie	10.7 MILLION	$939.2 MILLION
cle	69.5 MILLION	$881.7 MILLION
lcomm	12 MILLION	$503 MILLION

erScore

COURT DATES

Revenge of the Class-Action King

FOR YEARS, the Bush Administration has had securities class-action superstar William Lerach in its sights, targeting the lawyer in a probe into illegal kickbacks and pushing for laws aimed at curbing investor suits. Now Lerach, who has long maintained his innocence, is turning the tables with a maneuver that could play out just in time for the 2008 Presidential campaign.

On July 28, a federal judge in Dallas is expected to give the go-ahead to a class-action complaint against Vice-President Dick Cheney's old company, **Halliburton.** When the suit was first filed four years ago, the complaint didn't mention Cheney, although he was Halliburton's CEO at the time of the alleged wrongdoings. In subsequent filings, his name barely came up.

Now, a series of legal twists have made Lerach, a big donor to Democratic causes, the lead attorney in the class action, which has been refiled. (A judge threw out an earlier settlement.) And his rewrite of the complaint replaces "the defendants" with "Cheney's executive team" and drops Cheney's name 170 times in 183 pages. The Veep isn't a named defendant. The statute of limitations prevents that. But among other things, the complaint accuses him of insider trading and misleading investors about Halliburton's asbestos liability. "Cheney had motive to make Halliburton look good because of what he was involved in at the time—the election," says Lerach, adding that he is looking forward to deposing Cheney personally. A private lawyer for Cheney declined to comment for attribution but said the suit's allegations are without merit. *–Lorraine Woellert*

UPFront

MEDIA WATCH

LIGHTS, CAMERA, NO SMOKING

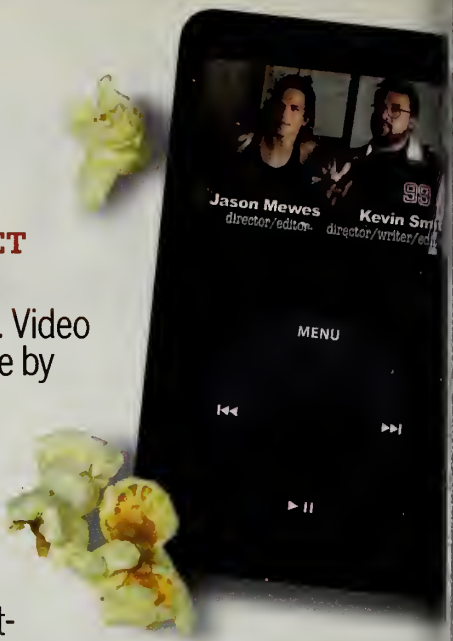
ON AUG. 1, INDIA will become the first country to ban images of smoking in all TV shows and new films. Under the directive, issued in June by Health Minister Anbumani Ramadoss, each time an actor lights up on TV, the screen must be blurred. Smoking scenes in existing films will be accompanied by a screen crawl warning of the dangers of smoking. The ban follows a previous directive requiring that, by next February, cigarette packs sold in India (where half the men and up to 21% of women smoke) must carry a skull and crossbones and photos of smoking-related ills—a mouth with cancerous tumors, for instance.

BOLLYWOOD
Bad example

In the U.S., where 20% of adults smoke, a new study from **Dartmouth College** found that 75% of 2004's youth-targeted films (rated G, PG, or PG-13) depicted smoking. In fact, among the 100 top-grossing films released each year from 1996 to 2004, such movies had more smoking in them than did R-rated ones. The study did find a decline in on-screen smoking overall, from 96% in 1996 to 77% in 2004. But "youths continue to see smoking in most of the movies they see," says Dartmouth pediatrician James Sargent.

–Catherine Arnst

ON THE SET



CALL THEM blogbusters. Video diaries made by directors or actors on a movie set have consistently been on iTunes' most-downloaded list this summer. Some of these moviemaking video journals remain on the site's top 100 list even after the movies are released. Among the latest entries: Actor Jac Black's videoblog about the making of *Nacho Libre* (which he also produced) and Zach Braff's videotaped diary about *The Last Kiss*, the upcoming DreamWorks comedy in which he stars. Director Kevin Smith pumped out 7 video posts about the making of *Clerks II*. Th got 3 million downloads before the movie came out on July 21. *–Heather Gre*

BLOGSPOTTING

WORD PROCESSING

womma.org/research/

» WHY READ IT Want to start a viral or buzz marketing program? Keep an eye on this blog from the Word of Mouth Marketing Assn. for the latest research on the topic. Recent posts muse on the state of podcast advertising (it's expected to surpass the blog advertising market by 2010), the number of CEOs who are blogging (just 7%), and the growing demographic of "surfer" moms. "They seek relationships, and they want to connect," posts one blogger about the 32 million mothers who spend time on social networking or online community sites. "They do not want just to download information."

–Jena McGregor

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UPFront

TANK TALK

WHAT'S PUSHING UP PREMIUM

Feeling super-squeezed at the pump when you fill up with premium? Here's why: The price difference between regular unleaded, which has an octane rating above 85, and premium gas (above 90) has risen from 23¢ a gallon to 30¢ nationally over the past year—bringing the average price per gallon for the high-octane stuff to $3.29.

Blame ethanol. The corn-based additive, which makes gasoline burn more cleanly, also evaporates more quickly than MTBE, the additive it has replaced. So refiners have to take extra steps to maintain the octane level of ethanol-blended fuel.

Prices for premium gas (whose high octane level helps prevent engine knock) are highest in the Northeast, where supplies of the special blends are tightest. In Boston, it's about 35¢ higher per gallon. The premium on premium isn't as steep in car-crazy California, in part because refiners simply lowered the octane level of premium fuel, from 92 to 91, when the state switched to ethanol additives three years ago.

–Christopher Palmeri

MAD AVE

FEEL FREE TO EMBARRASS YOURSELF

MAYBE IT'S because Americans have fewer "core" confidants these days, as a headline-grabbing study proclaimed in a recent issue of the **American Sociological Review.** Whatever the reason, at least three ad campaigns are currently using the same gimmick: asking people to reveal their secrets online.

The confessional Web sites are brought to you by **Secret** deodorant (shareyoursecret.com), **Greased Lightning** household cleaner (filthyconfessions.com), and TV's **Game Show Network,** whose site (gsn.com/secret) invites viewers to upload confessional videos to promote its remake of the 1950s quiz show, *I've Got a Secret.*

Secret spokeswoman Michelle Vaeth says the print and TV ads urging women to "share your secret" fit the **Procter & Gamble** brand's message about "feminine strength." Visitors to the Web site can view other people's entries (about 4,500 since mid-July), which run from the silly ("I'm addicted to Tetris") to the poignant ("I believe I was the reason my daughter turned to drugs"). The voyeuristic appeal is considerable, judging from the high number of "views" on some posts. "We're thrilled," says Vaeth. "It has been resonating really well."

So far nearly 10,000 consumers have spilled their guts to Greased Lightning's filthyconfessions by phone or with a fill-in-the-blanks template online.

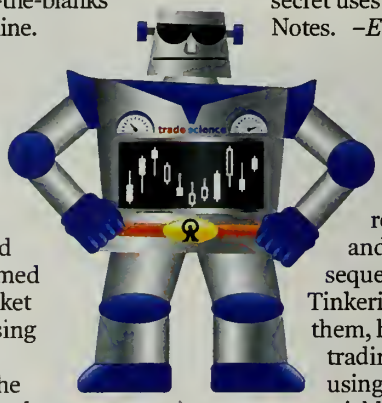
The basic idea isn't new 2004, ad shop **Crispin Porte Bogusky** ran a campaign fo **Method** soap asking shopp to "come clean" on a Web site. Beyond the ad world, popular PostSecret blog (postsecret.blogspot.com) l been displaying postcards scrawled with secrets sinc January of last year.

Wharton School marketin professor Americus Reed i skeptical about the payoff. call to bare our souls may t our desire to express ourselves, he says, "but it's far cry from motivating a person to buy deodorant." Marketers are betting he's wrong. **3M,** for one, says it' considering a campaign al secret uses for Post-it Notes. *–Elizabeth W*

STOCK ANSWERS

IS YOUR FUND MANAGER PLUGGED IN?

YOU'VE HEARD about robot space explorers and robot workers. Now a pair of Japanese companies—tech startup **Trade Science** and online securities firm **Monex Beans Holding**—has teamed up to provide robot fund managers for individual investors in Japan. If all goes as planned, next year investors will be able to choose from among 10 so-called Kaburobos, each offering a different investment strategy (tested using data from the past 15 years to see how it would have performed against market indexes). Using algorithmic programs, the robots will make the day-to-day decisions about what stocks and indexes to trade—and when.



MASCOT Trade Science's "Kaburobo"

The idea is the brainchild of Trade Science's CEO, Koichi Kato, who once worked for **Microsoft** in Japan. Kato had seen computer models at Tokyo's **Waseda University,** where researchers were working on artificial intelligen program for speec recognitio and genome sequencing. Tinkering with them, he created trading model using algorithr yielding annua returns of 300 Most tradin desks rely on automated models to arbit or anticipate market swing But Kato says no one has thought to market them tc masses. "Which would yo choose," he asks, "a fund manager you don't know robot with a clear track record?" *–Kenji*

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A Brighter Look

CLOSE READERS OF *BusinessWeek* may notice that the magazine looks a little different this week. Everything is where you expect it to be, but a bit more air is wafting through. That's because we removed the heavy bands at the tops of our pages and slightly reduced the type size of our topic headings to create what we think is a cleaner, more appealing look.

A magazine is always a work in progress as we listen to what you have to tell us and strive to serve you better. In the past year we have added The Welch Way by Jack and Suzy Welch, Face Time with Maria Bartiromo, Parker on Wine by Robert Parker, Media Centric by Jon Fine, and Outside Shot by nonstaff experts with provocative points of view. We've also brought to the magazine a weekly summary of news you need to know, called The Business Week, and an occasional feature, Feedback, that lets us have conversations with readers abou their letters and online responses to some of our key stories. We've tried t make our management coverage mo useful by distilling best-practice ideas in a format v call Playbook. And just las month we launched a quarterly magazine within the magazine, *IN: Inside Innovation*.

In the coming months v continue to pursue new w of enhancing *BusinessWeek* while preserving our focus timely content driven by c ful reporting, enriched by knowledge able and dispassionate analysis.

As always, we appreciate your thoughts. E-mail us at bwreader@businessweek.com.

Stephen J. Adler

EDITOR-IN-CH

UNREADABLE FINE PRINT LETS SPYWARE THRIVE

I HAVE THE SAME angry reaction to the installation of any unauthorized software on my computer as most of your readers ("The plot to hijack your computer," Cover Story, July 17). But surely the practice is legal, and it exists because no one has challenged the silly "license agreements" that are stuck in front of you during the installation process. The "agreement" appears in a hard-to-read window durin stallation. Even the most honest ve gives you pages and pages of legalese, buried in there somewhere is bound t something any reasonable person w find objectionable. The only decent ex ple I've seen recently is Microsoft Co "Genuine Advantage" license-chec program that arrived with my latest s rity updates. At least it popped up separate statement saying it was goi

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ll a program that reported my license
and asked if that was O.K.
better example is the rental-car agree-
t, where you have to initial an opt-
ut. Why don't computer vendors step
nd make licensing something con-
ers can understand, and offer an opt-
ut of controversial parts?

–Peter Thornton
Annapolis, Md.

NY COMPANIES have profited greatly
educed costs and improved services
g the Internet, making huge differ-
s in their staffing. By sponsoring
panies that produce pop-ups, spy-
e, and other infectious products,
e same companies are destroying the
ket. I wonder if their marketing de-
ments realize the long-term implica-
s of such a strategy?

–Robert Finkelstein
Reston, Va.

IZON SAYS VISION IS CLEAR

RECENT *BusinessWeek* essay was
ocatively titled "The phone compa-
still don't get it" (July 31). But the
y is based on an antique stereotype,
ch simply doesn't work for Verizon.
zon today is deploying the latest tech-
gy both for customers using our tra-
nal telecommunications service or
wireless service. We have shed much
ur old regulatory baggage, our work-
e is younger than it used to be, and
e brought the spunk of MCI into our
pany. Verizon Wireless is the nation's
ing wireless company. In short, we
n the move.

erizon is unique in deploying a state-
e-art technology—fiber all the way to
omers' homes and small businesses.
system exists only because Verizon
the industry to set standards and
ed manufacturers to build needed
pment. The scale of this project is
endous—6 million homes and busi-
es in 16 states will be able to use our
-optic service, FiOS, this year. We are
iding an unparalleled TV service on
system, and we've rolled out broad-
l data speeds as high as 50 Mbps. No
r player in our industry is doing any-
g like that.

erizon Wireless is deploying a wire-
broadband technology that blows
i away. It works in trains and cars, at
ites and in offices not just parks and
e shops. Customers can use it on
r laptops, cell phones and other
lheld devices. Again, no one is ahead
s or even close. Far from blocking wireless broadband, Verizon is the leader in deploying it.

No innovation? We are into games on computers and phones, music to the cell phone, and even beatboxing. An essay may be a personal point of view, but it should also reflect the facts. The facts show that Verizon very much gets it.

–Eric Rabe
Vice-President, Verizon
Basking Ridge, N.J.

SO MANY FOR-SALE SIGNS, SO FEW HOME SALES

I'M NO MARKET GURU, but if I subscribed to the Peter Lynch philosophy of investing, I'd place a big fat "short" on housing ("Housing: Where the market is really headed," Business Outlook, July 10). On my half-hour commute to work, I get a front-seat view of the market in Massachusetts, and it ain't pretty. More of my neighbors had for-sale signs on their front lawns this July 4th weekend than were flying the American flag. Housing prices seem to be holding, but no one seems to be making sales. What I do see are sellers swapping for-sale signs, believing the problem must be their Realtor. Eventually someone will blink, and I have a strong suspicion it won't be buyers.

–Van Ritter
Wrentham, Mass.

THE VALUE, AND THE DILUTION, OF THE COLLEGE WAGE PREMIUM

THERE ARE STRAW MAN arguments, and then there's Anthony P. Carnevale's attack on my work (often with Lawrence Mishel) regarding the importance of education ("Hitting the books still pays off," Outside Shot, July 17). Mishel and I have never denied the existence nor the importance of the college wage premium; to the contrary, we've publicized it. Our critique has never been against the value of any individual seeking more education. Instead, it has been against a policy whose sole solution to every economic problem is "more skills." This is especially important once you recognize the significant ways in which the education wage premium has changed over the past decades.

First, the wage advantage of college over high school workers rose by about 14 percentage points in the 1980s, about half that in the 1990s, and has been flat since. Second—and here Carnevale is wrong on the facts—the real earnings of college-educated workers have been flat or falling since 2000. *The Economic Report of the President*, for example, shows a 5% loss in the annual earnings of college graduates from 2000 to 2004.

In no way do these facts suggest that one shouldn't go to college. In every way they suggest that factors such as offshoring, more narrow skill differentiation by companies, and weakness in certain sectors (e.g., information technology) have lessened demand for college-educated workers. Younger college-educated workers have had a particularly rough time in recent years, both in terms of fewer employment opportunities and declining real wages. To no small extent, a college degree is no longer insulation from the myriad forces that have been slowing the growth of living standards for the 70% of the workforce without college degrees.

–Jared Bernstein
Economic Policy Institute
Washington

> "A college degree is no longer insulation from the myriad forces that have been slowing the growth of living standards."
>
> *–Jared Bernstein*
> *Washington*

How to reach *BusinessWeek*

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Geography Is Destiny

IN 1994, CARNEGIE MELLON University professor Richard Florida was paging through a newspaper when a headline triggered what he calls a "holy moly" moment. Lycos, a search-engine company spun out of CMU, announced it was moving from Pittsburgh to Boston. When Florida asked why, colleagues told him that "Boston offered the lifestyle options that made it easier for Lycos to attract top creative and entrepreneurial talent," he recalls.

This explanation sparked a powerful insight: Clustered in certain U.S. cities, there is a group of innovative people—about 38 million of them, by Florida's latest calculation—that generate far more than their proportionate share of wealth. Florida pegged their annual wages and salaries at about $1.7 trillion in 2003, and he has chronicled their behavior and motivations in two influential books: *The Rise of the Creative Class* (2002) and *The Flight of the Creative Class* (2005).

Based on U.S. labor and census statistics, Florida, 48, figures the members of this cadre, including entrepreneurs, musicians, scientists, designers, and engineers, made up 10% of the workforce in 1900. Today they account for almost 30%, produce nearly half the country's yearly wages and salaries, and are far more mobile than ever before.

If you're not in a creative city, says Florida, you won't attract top talent

Since 2002 thousands of mayors, urban planners, and business leaders around the world have relied on Florida's research and consulting services to lure talent. *Rise* includes a Creativity Index that ranks U.S. cities based on how well they foster technology, tolerance, and talent, which Florida calls "the three Ts." Leading the 2004 ranking of 276 metro areas were Austin, Tex., San Francisco, and Seattle. New Yo was No. 20.

In *Flight*, Florida broadened the picture, drawing on International Labor Organization data to develop a Global Creativity Index, which ranks countries as well as cities. The U.S. came in fourth—behind Sweden, Japan, and Finland—a a "global talent magnet." U.S. visa and immigration obstacle Florida says, now deter the kinds of foreigners who helped fu American economic growth and innovation in the past. The U.S. should emulate Canada's famous "mosaic" model, whic nourishes the creativity of individuals by offering social support to ethnically diverse communities.

Florida woke up to innovation as a child, when he visite his father's eyeglass-frame factory in Newark, N.J. His fath was a manager at a plant where German and Italian machinists experimented on the shop floor, spawning ideas that anticipated today's colored frames. His father, a first-generation American from a large Italian family, said something that eventually became a mantra: It' not the machines or the technology that matter, but "the knowledge, intelligence, and creativity of the people."

In the 1960s, Florida watche as Newark, a thriving industrial city, was ripped apart by riots. This inspired Florida to study urban planning at Rutgers, Massachusetts Institute of Technology, and Columbia University, where he received his PhD in 1986.

Some of the indexes that Florida developed to measure h three Ts have sparked controversy. For example, he include Gay Index in his calculations of a region's tolerance, arguin that the area's appeal to homosexuals is a gauge of its openness to all newcomers. But Florida laughs when he is accused of harboring a diversity agenda. "I'm a science, technology, and economic growth geek, that's all," he says.

Now a public policy professor at George Mason Universit Florida continues to look at how different regions—especial in China and India—compete for talent. He has also worke locally, collaborating with various groups on the regenerati of Lower Manhattan. His next book, due in 2007, continues connect the dots between people and places. "Where you choose to live is the most important decision of your life," h says. "This book will explain why." ■

–By Aili McConn

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BY JAY GREENE

One Slick Sidekick

For the white-collar crowd, the BlackBerry has evolved into the must-have gizmo for staying in touch. For the ripped T-shirt crowd, it's T-Mobile's Sidekick. Part phone, part e-mail device, it has become a cultural phenomenon in the four years since it launched. Demi Moore used her Sidekick to carry on a digital chat with boyfriend Ashton Kutcher on David Letterman's show. And last year, Paris Hilton famously had her Sidekick hacked, flushing phone numbers of the rich and famous out onto the Web.

T-Mobile's newly released Sidekick 3, made by Sharp, is likely to prolong the product's winning streak. It's about 20% smaller than the previous version and weighs just 6.7 ounces. It has an ample 2.6-inch screen that swivels up neatly to reveal a small QWERTY keypad, one which you type with your thumbs.

Perhaps the nicest innovation of the Sidekick 3 is a tiny trackball just to the right of the screen that you can use to navigate all the Sidekick's features. This replaces a scroll wheel on the Sidekick 2, and it's the easiest way to move through a handheld device I've ever tried. Roll the ball toward you to scroll down a Web page. Push it, and you open applications.

But the true delights of the Sidekick 3 are instant messaging and e-mail. I'm not talking about phone-to-phone text messages—cryptic shorthand you can decipher only if you were born during the Clinton Administration. I'm referring to real instant messaging, the way millions of folks communicate via PCs. The Sidekick 3 comes loaded with IM software from AOL, MSN, and Yahoo!. Type in your user name and password, and you're chatting away. I set it up during a lunch break and was instantly in touch with pals on MSN's Messenger software. The only challenge was typing fast enough on the small keypad to keep the dialogue moving, something I got better at with practice.

E-mail is a bit trickier. Things went smoothly as long as I was e-mailing from the T-Mobile account that comes with the device. Setting up Sidekick to get mail from a home account supplied by my local Internet provider was more trouble, but eventually I got it going. One drawback: The Sidekick can't grab e-mail from servers protected by firewalls, so it won't work with most business accounts.

The newest model connects to the Web using a semi-fast network known as EDGE, which is a far cry from broadband on a laptop but fast enough for light browsing. The Sidekick's screen is generally adequate for the task, depending on what site you're trying to hit. I had no trouble using Google to find the address of a local restaurant, but my 11-year-old struggled to goof off on a graphics-heavy game site—defeating the whole point of goofing off.

Another first for the Sidekick: This third iteration includes a digital music player. Sharp has built in a pretty good speaker, so you can share your music with a buddy without having to share your earbuds. True, the Sidekick is no iPod. But at least you won't have any problem finding the song you want to listen to—the 64-megabyte miniSD card that comes with the phone holds only about 15 of them. I recommend upgrading to a larger card, especially if you plan to take pictures, as these are on the same card.

T-Mobile's latest hip gadget keeps you in touch, but not with office e-mail

A big drawback of the Sidekick 3 is that it's a power hog. That's understandable, considering you can use the device to Web surf, instant message, play music, and—oh, yeah—make phone calls. T-Mobile says the talk time is not 4½ hours and the standby time is three days, but you'll be hard-pressed to go more than a day without recharging. Once I neglected to recharge the device overnight and was stuck the next day with a useless brick in my pocket.

T-Mobile charges $300 for the device with a two-year contract, $350 with a one-year contract, and $400 on a pay-as-you-go plan. You'll also need to buy a data plan on top of your regular phone service, which runs $30 a month. It ain't pocket change, but whoever said being hip was cheap? ■

E-mail: techandyou@businessweek.com

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MediaCentric

BY JON FINE

Front Page News? Not Quite

Sometimes I get in a certain mood and spend too much time mulling the tone with which magazines and newspapers write about their important advertisers, scrutinizing every adjective and nuance for evidence of punches pulled and reputations gilded. Then I usually get over it and mo on. From what I'm hearing these days, others don't. In mid-July, *The Wo Street Journal* announced that later this year it will start running ads on its front page—the lower-right-hand corner of the front page, to be precise. Also, the *Chicago Tribune* is exploring running ads on the front pages of its internal sections, something *The New York Times* has been doing for some time. There are, of course, financial reasons for all this. Wall Street analysts nod their approval at management estimates that the *Journal*'s move will bring in around $10 million annually. (Given what's happened to the paper's ad revenues since 2000—hey, it helps!)

The announcements made knees jerk in certain traditionalists' circles. Bob Steele, director of ethics at journalism think tank the Poynter Institute, expresses many concerns about the *Journal*'s move. They range from the semi-tangible (an ad means less news space on the front page—but lead *Journal* stories jump to other pages) to the fanciful (he cites research that concludes that a reader's eye goes to visuals first, which means the news may be upstaged, which by extension threatens every newspaper and magazine article that's adjacent to an ad). One blogger wondered how it would look if CNN put ads in the ticker-style "crawl" that runs along the bottom of TV screens, which would only be analogous to the *Journal* if the paper started running ad copy mid-sentence.

PEOPLE, THIS IS STUFF FOR THE CROP-CIRCLES crowd. Does anyone beyond the most navel-gazing of journalists care in the slightest about a small ad appearing on the front page?

"It's arbitrary to say: 'It's O.K. to have an ad facing a page but not have an ad on the page,'" says a top editor at a major magazine. "That's silly and dumb and biased toward the status quo." Make that the very recent status quo. As Steele himself admits, there's a much longer tradition of American newspapers with front-page ads than without. It's only in the past 30 or so years—the post-Watergate era that solidified "objectivity" as a journalistic ideal—that such ads stopped appearing.

Irony of ironies, Steele points out, with grace, that one newspaper that ran front-page ads into the early 1980s is the well-regarded *St. Petersburg Times*. It did so with the explicit approval of its patriarch, Nelson Poynter, whose name is synonymous with stringent journalisti standards and whose fortune endows the institute that employs Steele.

Print is at a disadvantage with advertisers these days. Other media offer ad opportunities that get prod into the fabric of the programmin product placement on TV shows, pop-up ads zooming off an artic found on nytimes.com (or, for th matter, businessweek.com).

Some time ago the publisher of respected magazine grumbled to m that he had to compete for ads with t media "with ankle weights on." If this publisher wants to toss pro placement into articles, wel that's stupid, because it hur the product and, by extensi the value of the enterprise; putting sawdust in the corn flakes. But if this publisher keep profits afloat by selling strangely shaped ads or cle marked ads in unusual plac what's the harm?

As long as advertisers aren't coddled in stories, who cares where their ads appear?

I don't like the *Journal*'s move on aesthetic grounds would prefer that an ad not break up the elegance of th paper's front page, that pleasing expanse of print and pix portraits. But I don't pretend that argument carries much weight, especially in stingy times like these. This isn't art. business. So slam the door on advertisers that demand ki glove treatment in the news pages. Roundly ridicule those that pull ads from publications that dare hit them hard, as General Motors did to *The Los Angeles Times* last year. But much of the rest is fair game. ■

BusinessWeek online For Jon Fine's blog on media and advertising, go to businessweek.com/innovate/FineOnMedia

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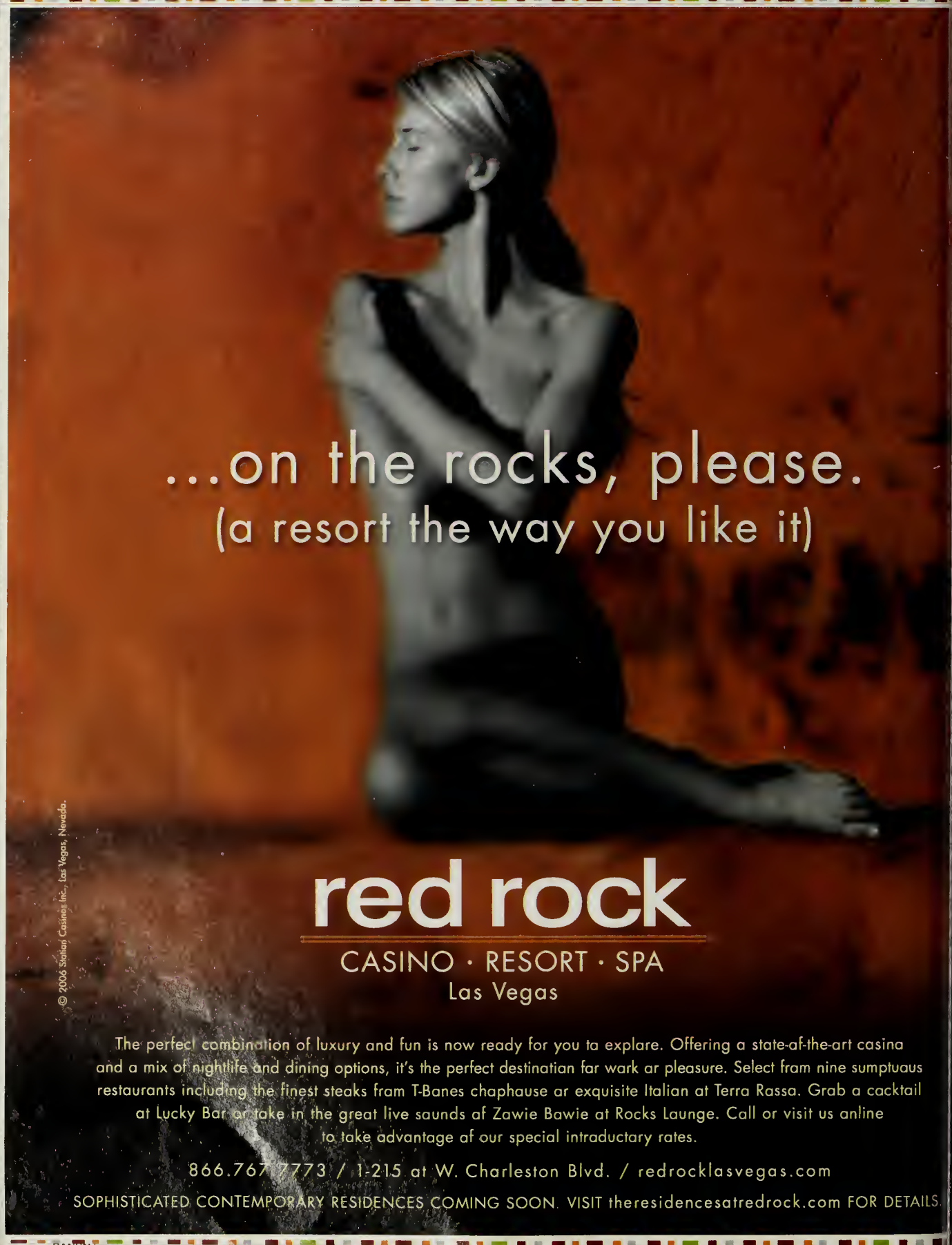
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JAMES C. COOPER

The Fed Gives Investors Their Dream Forecast

t will slower growth cool inflation enough to forestall further rate hikes?

U.S. ECONOMY The stakes are always high on Wall Street, but for e months ahead the Federal Reserve has upped the ante for vestors even more. In his July 19 congressional testimony, Chairman n Bernanke laid out the Fed's updated economic forecast, which pects the economy to slow and the current pickup in inflation to

e temporary (table). Because that scenario is a recipe n end to the Fed's interest rate hiking, market players bid up prices for both stocks and bonds on the bet the Fed's outlook is a winner.

ut how will investors know when to hold 'em and n to fold 'em? The key lies in the Fed's forecast for nomic growth. Policy moves in the months ahead will t likely depend more on future growth than on the ern of inflation. Policymakers generally expect real s domestic product to grow 3¼% to 3½% this year, sured from fourth quarter to fourth quarter.

ut look what those numbers imply. Given the nomy's first-half pace of about 4%, growth in the nd half will have to average in the neighborhood of % for that projection to hold up. That's quite a down. In coming months, any sign that the nomy's pace is not cooling off to that degree would concerns at the Fed—and on Wall Street—that tion will not ease back next year, and more rate hikes be needed.

he stakes are especially high on the Fed's growth cast. That's because policymakers now appear willing cept slightly more inflation in the coming year, pared with their February forecast, in the belief that er growth will allow inflation to recede in 2007. The sees its favored price gauge—the price index for onal consumption expenditures (PCE) excluding gy and food—rising 2¼% to 2½% this year, then ing into the range of 2% to 2¼% in 2007. But those bers are well above the oft-stated 1% to 2% "comfort " of many policymakers.

FED'S FORECAST and Bernanke's testimony ificantly altered Wall Street's mindset on the path of re policy. That much was clear from the market tion—or lack of reaction—to the June consumer price x. The report came out on the morning of Bernanke's ange with the Senate Banking Committee, and it was t all market- or Fed-friendly.

he overall CPI rose 0.2% from May, but the core x, which excludes energy and food, jumped 0.3% for ourth month in a row. It was the previous string of lar increases that had so alarmed the markets about inflation and the Fed's response. The rise meant that core inflation for the first half of the year was running at an annual rate of 3.2%, the fastest six-month pace in more than a decade. However, by the end of the day, the Dow had soared more than 200 points, and bond prices jumped, sending yields lower.

The Fed's big bet is on the time lags involved with policy changes and their impacts on growth and prices. As Bernanke noted: "The lags between policy actions and their effects imply that we must be forward-looking." Some of the influence of past rate hikes, he said, is "still in the pipeline." Moreover, inflation tends to lag behind the ups and downs in the economy's growth rate, so slower growth is imperative both for inflation to recede and for the markets to stay buoyant.

THE FED'S OUTLOOK: PICTURE PERFECT?

FED'S CENTRAL TENDENCY FORECAST
(4Q TO 4Q PERCENT CHANGE)

	2006	2007
REAL GDP	3.25-3.5	3.0-3.25
CORE INFLATION*	2.25-2.5	2.0-2.25
UNEMPLOYMENT RATE (4Q AVG.)	4.75-5.0	4.75-5.0

*PERSONAL CONSUMPTION EXPENDITURES PRICE INDEX EXCLUDING FOOD AND ENERGY

Data: Federal Reserve

BERNANKE'S MARKET-SOOTHING REMARKS echoed the tone of the Fed's statement after the June 28-29 policy meeting. The recently released minutes of that meeting show that policymakers listed three reasons why this year's uptick in inflation would moderate in the coming year, including "contained inflation expectations, the abatement of upward pressure from past increases in energy and other commodity prices, and the slowing in the growth of economic activity that was under way."

In fact, based on one unusual reason given for the June 29 rate hike, the Fed seems to be leaning toward taking a pause at its Aug. 8 meeting. Officials agreed that tough talk on inflation leading up to the June meeting had lowered market expectations of inflation. Maintaining those tamer expectations, they said, all but required the Fed to hike rates—not because of the patterns in economic growth or inflation but simply because the markets expected a hike.

Bernanke also played down some of the recent rise in the core CPI, noting the large influence of that gauge's

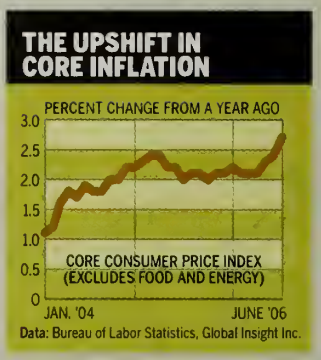
rent-based measure of housing costs. This index is now producing the odd result that housing costs are rising instead of falling as housing markets weaken. In response to a question, Bernanke said that was one of the reasons the Fed preferred to look at the core PCE price index, in which this technique for measuring housing costs has a much smaller weight.

One big reason why the Fed appears so sanguine over the inflation outlook is the failure, at least so far, of wages and other labor costs to push prices higher. Productivity has been too strong to allow that. The Fed's Monetary Policy Report, submitted to Congress with Bernanke's testimony, noted that while productivity growth has slowed over the past two years, it is still matching the solid pace of the second half of the 1990s.

Strong productivity gains are a key reason why profit margins have soared to an all-time high in this business expansion, and Bernanke said he believes that high efficiency and margins will eventually allow wages to rise faster without putting undue pressure on prices.

THE QUESTION FOR THE NEXT FEW MONTHS is this: Will the markets be as tolerant of the recent pickup in inflation as the Fed appears to be (chart)? That will depend on whether the upcoming growth-related data support the Fed's forecast for a cooler economy at a time when the need for slower growth is becoming more urgent. The economy appears close to running out of spare production capacity needed to meet new demand. The industrial operating rate is at a six-year high, and tight job markets have pushed unemployment down to a five-year low, a situation that could pressure prices even more.

So far, the numbers, especially for housing, are playi out the way the Fed and the markets would like. Home demand continued to weaken in the second quarter as June sales of existing homes dipped 1.3% from May, an rising home inventorie and a continued slowdown in the rate o price increases. Builde are reeling. Starts of ne homes fell in June for t fourth month in the pa five, capping off the weakest quarter for sta in three years.



However, consumer remain surprisingly optimistic. Neither Mideast turmoil nor higher gasoline prices prevented consumer confidence from rising in July for the second month in a row. The Conference Board's survey said that household attitude toward the job markets remained upbeat.

The consistent resilience of consumers and the overa economy remains the biggest risk in the Fed's forecast. But perhaps the most important reason why investors should be wary of the policymakers' outlook is that they are projecting a picture-perfect result for both growth a inflation. Economic forecasts are rarely that good.

LABOR MARKET

Hiring Shifts to a Lower Gear

THE NEXT EMPLOYMENT report, due on Aug. 4, is likely to show another month of tepid job growth. Indeed, some key employment indicators are looking a bit bearish, and economists are ratcheting down their forecasts. What's more, if the Federal Reserve is right, weaker employment gains are here to stay for the rest of the year.

So far this year, the number of temporary workers and those hired by employment placement agencies and employee leasing services is down by nearly 32,000. Trends in employment services often foreshadow broad hiring trends. Temporary workers are generally the first in when companies need more help and the first to go when conditions soften.

Since the Labor Dept. began tracking employment services hiring back in 1985, there have been four other periods when payrolls in this category have fallen over a six-month stretch. In all but one instance, nonfarm private payrolls also fell. The only exception was a very brief dip in 1995 that was followed by a short but sharp slowdown in overall hiring.

Other employment indicators look less optimistic as well. Through May, the Conference Board's index of help-wanted ads has dropped three straight months to the lowest level in over 40 years. And while initial jobless claims remain low, the total number of jobless persons collectir benefits is turning up.

Three months of lower-than-expected job gains along with risin and volatile energy prices have economists lowering expectations f July hiring, to around 145,000 jobs But gains in July and the rest of the year could be weaker, based on the Fed's revised economic projections The central bank is forecasting a jobless rate between 4.75% and 5% yearend, up from 4.6% in June.

In the past, the rule of thumb wa that monthly job gains consistently running under 150,000 would lead a rising unemployment rate. In his testimony before Congress on July Chairman Ben Bernanke lowered t number to around 130,000 becaus demographic shifts in the labor for If the Fed is right about the uptick the jobless rate, then further tepid numbers on payrolls will be in stor

–By James Mehring in New Y

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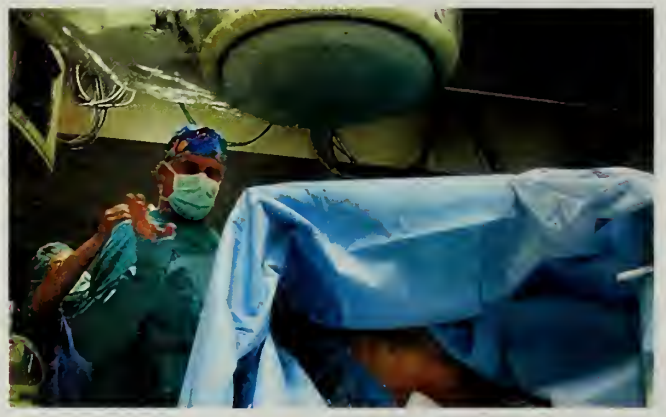
The Business Week

News you need to know

EDITED BY MICHAEL ARNDT



Barbarians at the Gate II Private-equity outfits have been snapping up companies like there's no tomorrow. Now, a trio of investment firms, including storied **Kohlberg Kravis Roberts,** has topped all others. With a record $33 billion bid, including $11.7 billion of debt, the firms said on July 24 that they would take over **HCA,** the nation's largest hospital chain. The price tag surpasses the record holder, KKR's $31.4 billion buyout of **RJR Nabisco,** a 1989 deal described in the book and film *Barbarians at the Gate*. KKR's partners in the HCA deal are **Bain Capital** and **Merrill Lynch,** as well as the family of Senate Majority Leader **William Frist** (R-Tenn.), whose father and brother founded HCA in 1968. In another sign of the buyout frenzy, **Blackstone Group** was reported to be mulling a higher bid. This is HCA's second attempt at going private. The Nashville-based chain of 176 hospitals and 92 surgery centers was acquired in a 1988 leveraged buyout. It reemerged in 1992.

See "Buy it, strip it, then flip it," page 28

HP and AMD Deal, Too Feeling flush itself, **Hewlett-Packard** agreed on July 25 to pay $4.5 billion for **Mercury Interactive,** a business software company. It was **Mark Hurd's** first major purchase since he became HP's CEO 16 months ago. A day earlier, **Advanced Micro Devices,** which has been gaining ground on its larger rival, **Intel,** said it would take over computer chipmaker **ATI Technologies** for $5.4 billion.

ONLINE *See "AMD + ATI : Imperfect together?" www.businessweek.com/go/tbw*

SEC Cracks Down on Options Hoping to shut barn door before all the cows have run loose, the **Securi & Exchange Commission** voted unanimously to toughen ru on options grants. Starting next year, companies will h to explain how they value stock options and why th choose the award dates they do. The July 26 get-tough v comes a week after two former executives at **Brocade Co munications Systems** were charged criminally with backd ing options to inflate their value to employees. Doz more companies have acknowledged they are under inv tigation for similar practices.

Deathwatch for Doha "Between intensive care and crematorium." That's Indian Commerce Minister **Ka Nath's** take on the global free-trade talks that were s pended by the **World Trade Organization** on July 24. The D Round of talks began with high hopes in 2001, but polit pressures from back home prevented negotiators from c ting a deal. Europe and the U.S. balked at reductions farm tariffs and subsidies, while Brazil and India kept th own markets closed. If Doha can't be resuscitated—and one sees a Lazarus act here—the world could fragm into regional trading blocs.

ONLINE *See "Why Doha's derailment matte www.businessweek.com/go/*

Big Pharma's Big Numbers Big-name drugs don't j help patients; they've taken the pharmaceutical sector its sickbed, too. **Merck** and **Schering-Plough** emerged on J 24 as two of the most prominent winners. Both enjo soaring demand for cholesterol-lowering drugs, includ Zetia and Vytorin, which they market through a joint v ture. **Glaxo, Eli Lilly,** and **Wyeth** also posted higher earni Big Pharma is profiting from the new Medicare Part D d benefit, which has fueled an increase in prescriptions.

GM Outrevs Ford Detroit's Big Two are like cars pass in the night. **General Motors** wowed investors on July 26 v impressively strong operating profits and a 12% jump revenue, to $54.4 billion. Although GM posted a net los $3.18 billion, its global auto operations had their first pr since 2004, excluding one-time expenses. Its GMAC fina unit also set an earnings record on better returns fi mortgage lending. Meantime, **Ford Motor** smacked inves with a second-quarter loss of $123 million; analysts w predicting a $230 million profit. Ford is now hastening cuts and plant closingsto bring operations in line with shrinking market share.

ONLINE *See "GM's Wagoner gets some breathing roo www.businessweek.com/go/*

Dell to Investors: Oops! The world's largest PC ma disappoints again. In the latest in a string of quart warnings, **Dell** said on July 21 that its second-quarter s would come in at $14 billion, shy of the projected $14.2 lion, and earnings would total 21¢ to 23¢ a share, short of the expected 32¢. The culprit this time: fall

s in the commercial market, which accounts for 85% ell's overall revenue, as well as heavy spending to im- e its oft-slammed customer service and tech support.

ONLINE *See "What Dell should do," www.businessweek.com/go/tbw*

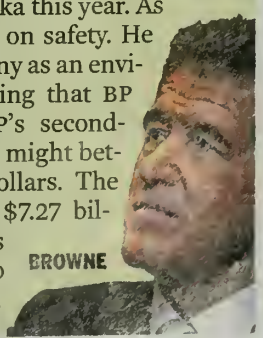
ommerce Thuds Two of the Internet's hottest hot- ren't anymore. **Amazon.com** said on July 25 that its sec- quarter net plunged 58% on a 22% rise in sales. Rev- was hurt by an end to its linkup with **Toys 'R' Us.** The kup plus bigger tech investments for new digital me- fferings were to blame for tanking profits. Shares lost of their value. Earlier, **Yahoo!** sank after saying it d delay the launch of a long-awaited project, code- ed Panama, to make its search business more compet- with market leader **Google.** The news, disclosed on 18 as Yahoo reported a big drop in earnings, triggered % plunge in its shares to a two-year low. They have yet cover. Panama, essentially a rebuilt online ad system, will be released in early 2007.

ONLINE *See "Amazon investors feel the sting," www.businessweek.com/go/tbw*

Housing Bubble Leaks More Air Better trim the s around that for-sale sign out front—it might be there ile. On July 25 the **National Association of Realtors** said upply of unsold existing homes was the biggest since 1997: a 6.8-month supply at the current sales pace. s were up just 0.9% from a year earlier, the smallest in 11 years. Things are worse for owners of co-ops and os, the market where speculative fever ran the hottest. ian prices fell 2.1% in June from the year before, while olume of sales was off 10.9%.

Impending Exit of the Week

s John Browne is stepping down. While reporting ord profits on July 25, the long-standing chief execu- announced he'll retire at the end of 2008, 10 nths after turning 60. What a run he's had. Since ing over in 1995, he has transformed BP from a big company into a really, really, big oil company with takeovers of **Amoco** and **Arco** in the U.S. He also led industry into Russia by paying $8 billion in 2003 half of what is now called **TNK-BP.** Browne has had woes, of course. A 2005 blast at BP's Texas City x.) refinery killed 15 workers and injured 170. A BP elne also sprung a leak in Alaska this year. As esult, he just upped spending on safety. He tried to reposition the company as an envi- mentalist, with ads proclaiming that BP s Beyond Petroleum. But BP's second- rter results showed its initials might bet- stand for Billions of Petrodollars. The ndon-based company earned $7.27 bil- —$80 million a day—on sales $73.47 billion, second only to lly, really, really big **ExxonMobil.**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PRIVATE EQUITY

BUY IT, STRIP IT, THEN FLIP IT

The quick IPO at Hertz makes buyout firms look more like fast-buck artists than turnaround pros. Investor beware

BY DAVID HENRY AND EMILY THORNTON

THIS MIGHT GO DOWN AS the year of the swashbuckling buyout. On July 24 three big private-equity players offered $33 billion to snap up hospital operator HCA Inc. in what would be the biggest leveraged deal in history.

But a much quieter event a few days earlier might be a better example of the excesses this era has wrought. On July 14, less than seven months after the private-equity trio of Clayton, Dubilier & Rice, Carlyle Group, and Merrill Lynch Global Private Equity bought Hertz Corp. from the ailing Ford Motor Co. for $14 billion, the group filed a preliminary prospectus with the Securities & Exchange Commission to sell shares in an initial public offering.

Buyout firms are celebrated for their ability to take on huge debts, buy neglected companies, turn them around over the course of several years, and sell them to public investors for huge profits. Since 2001 they have delivered to their investors annualized returns in excess of 20%, and have attracted record amounts of capital to buy even bigger companies (page 98). But the quick "strip and flip" the Hertz buyout firms are pulling off makes them look more like fast-buck artists than thoughtful turnaround specialists.

The Hertz crew hasn't said how much of the company it intends to sell. But it sure hasn't been shy about backing up the Brinks truck. Three weeks before the initial IPO filing, the owners had Hertz take out a loan to pay themselves a $1 billion special dividend—nearly half of the $ billion in cash it had invested in Dec ber. So hungry were they for the cash t they collected it even before recruitin new CEO to run the company. Needles say, special dividends like this subst tially improve the buyout firms' r reward prospects. Principals at the t buyout firms would not comment wh the deal is in registration.

In their filing, the owners say they tend to use the new money from pu stock investors to repay the $1 billion l that paid for their dividend. They c also recoup some of the rest of the c they put up. Regardless, they will re majority ownership of the company a the IPO.

The Hertz group is hardly alone i zeal to go public. Buyout firms have p eted $9 billion this year in 32 IPOs. average they've raised $287 million v each listing, compared with the $169 lion raised by companies with no buy firms involved. In total, their compa account for 29% of all IPOs, up f slightly less than 5% in 2000, accor to Thomson Financial.

The question is: Will the Hertz dea good for public investors? If other re

Rent-a-Company

Leveraged buyout firms took a quick ride with Hertz

JUNE, 2005 Ford files for IPO of Hertz to take it public

SEPTEMBER, 2005 Ford drops IPO, agrees to sell Hertz for $14 billion in LBO

DECEMBER, 2005 LBO group puts up $2.3 billion in cash for deal, borrows the rest

JUNE, 2006 LBO group pays itself $1 billion obtained from new Hertz debt

JULY, 2006 LBO group files for IPO

Data: Company reports, Standard & Poor's

Hertz

CHARRED Burger King's stock is down 12.6% since its IPO

IPOs are any indication, the answer is a resounding no. On average, the stocks of companies taken public by buyout firms this year have fallen 6%. In contrast, shares of companies that have gone public without any assistance from buyout firms have risen 0.7%. And shares of companies that make up the Standard & Poor's 500-stock index have gained 1%.

These are the very companies that were supposed to benefit from comprehensive turnaround plans. The secret to buyout firms' success in recent years has ostensibly been their ability to fix up struggling companies once they've been privatized, then collect windfalls after taking them public again. Private ownership allows managers to take drastic measures that aren't easily carried out under public scrutiny, such as slashing costs and shedding unnecessary assets and operations.

But are buyout firms really doing that? You certainly can't tell from the stock market performances of the ones taken public this year. Almost two-thirds are now underwater—some deeply so (table). In a July 20 report following the Hertz announcement, Thomson Financial had two words for its clients considering buying shares of companies taken public by buyout firms: caveat emptor.

IPOs like the Hertz deal have fared poorly this year. The other ubiquitous consumer company to go public, Burger King Holdings Inc., was down 12.6% from its offering on May 17 through July 24. And another company taken public less than a year after its purchase has slumped, too: Managed care provider HealthSpring Inc. was down 7.9% through July 24.

The buyout firms have their own investors, and it's hard to fault them for taking advantage of the accommodating stock and credit markets to grab cash when they can. But what keeps enticing investors to buy into these IPOs? The hope of good long-term performance, it seems. Soon-to-be-released research by professor Josh Lerner at the Harvard Business School will show that in the last two decades, companies taken public by buyout firms have outperformed other IPOs and the major market indexes. That's because buyout firms usually take three to 10 years to carry out the sort of operati improvements that could justify t huge payouts in IPOs.

Buyout firms have pocketed $9 billion this year in 32 IPOs

But the Hertz trio has owned the c pany only since Dec. 20. The new c executive, Mark P. Frissora, form chairman and CEO of auto parts sup er Tenneco Inc., reported to work on 19—five days after the IPO registra was filed. He's the first Hertz CEO hasn't come from within company or the indu notes Neil Abrams, a re car industry consultant former Hertz execu Since the buyout firms t over in December, the substantial operati change Hertz has made hold customers more countable for dings dents, says Joe Brancatel Joesentme.com, a frequ traveler Web site.

What the buyout firms can do qui is use their financial might. The Hertz easily delivered money Ford craved before the purchase closed, the bu arranged to take advantage of the str demand for fixed-income investment

ritizing Hertz rental cars. In other ls, they hocked the cars and raised billion toward funding the buyout—etter terms than if they had borrowed e junk-bond market, as was common rlier buyout waves.

ne trouble is, putting up assets as col-al reduces a company's financial flex-y. That's one reason Standard & 's, the credit-rating agency, down-ed Hertz from investment-grade to ulative, or junk, status after the buy-S&P says Hertz has pledged two-ls of its assets now, vs. just 10% be-the buyout.

EEZED

TZ WILL NEED flexibility as it faces a wash from the troubles at Ford and eral Motors Corp. As the automakers production capacity, they're not un-ing cars to the rental companies as ply as they once did. Hertz says its s won't be nearly as predictable in the re. Already, higher car costs from De-have pushed Hertz' depreciation s up 17% for 2006 models. The busi-is also at risk of higher oil prices ing up airline fares and reducing air ic. About 72% of Hertz' car rental rev-es come from airports. And the new debt will hurt. Hertz' first-quarter in-st expense jumped 112%, prompting a loss of $49 million, compared with ncome of $21 million a year earlier.

ertz' new owners do have plans to ngthen the business. One strategy: to st rentals away from airports. Such rational improvements should lift it margins, which are down from O levels, according to the preliminary pectus. And Hertz, the world's sec-largest rental car chain after Enter-e Rent-A-Car Co. with 7,600 rental lo-ons in 145 countries, notes that it's of the world's best-known brands. n that kind of base, the buyout boys uld have room to turn around the pany they've been so quick to load up debt. Eventually.

ut in the meantime, be careful how h you pay them for their shares. If ger King and the other IPOs are any cation, Hertz' stock might stall out after hitting the public freeway. yout firms sell when they can," says ran money manager Michael Holland lolland & Co., who was a partner at Blackstone Group before setting up own shop in 1995. "You have to over-e the initial skepticism about the fact a smart person is selling something." eat emptor indeed.

–With David Kiley in Detroit

Initial Public **Awfulness**

Most of the 32 IPOs backed by private-equity firms in 2006 have fared poorly

Companies	Buyout IPO Date (2006)	Amount raised from IPO (millions of dollars)	Return to investors*
1. H&E EQUIPMENT SERVICES	Jan. 30	226	46.2%
2. KOPPERS HOLDINGS	Jan. 31	161	39.6
3. HOUSTON WIRE & CABLE	June 14	110	35.6
4. J. CREW GROUP	June 27	432	25.7
5. ENERGY TRANSFER EQUITY	Feb. 3	507	22.6
6. REGENCY ENERGY PARTNERS	Jan. 30	283	20.9
7. PGT INDUSTRIES	June 27	123	11.9
8. AMCOMP	Feb. 9	97	9.4
9. NIGHTHAWK RADIOLOGY HOLDINGS	Feb. 8	116	9.4
10. ALLIED WORLD ASSURANCE	July 11	344	1.8
11. VERASUN ENERGY	June 13	483	1.0
12. LINN ENERGY	Jan. 12	261	–0.2
13. RAM HOLDINGS	Apr. 27	141	–5.4
14. EXCO RESOURCES	Feb. 8	697	–6.9
15. HEALTHSPRING	Feb. 2	422	–7.9
16. MAGELLAN MIDSTREAM HOLDINGS	Feb. 9	539	–12.2
17. BURGER KING HOLDINGS	May 17	489	–12.6
18. TOWN SPORTS INTERNATIONAL	June 1	116	–14.3
19. GOLFSMITH INTERNATIONAL	June 14	69	–15.2
20. EAGLE TEST SYSTEMS	Mar. 8	101	–15.5
21. SMART MODULAR TECHNOLOGIES	Feb. 2	164	–17.1
22. SEALY	Apr. 6	515	–18.1
23. COMPLETE PRODUCTION SERVICES	Apr. 20	718	–19.5
24. GOODMAN GLOBAL	Apr. 5	487	–22.3
25. CPI INTERNATIONAL	Apr. 27	127	–22.6
26. CASTLE BRANDS	Apr. 5	31	–23.2
27. CLAYTON HOLDINGS	Mar. 23	127	–29
28. MORGANS HOTEL GROUP	Feb. 13	360	–29.8
29. AVENTINE RENEWABLE ENERGY	June 28	389	–31.7
30. DYNCORP INTERNATIONAL	May 3	375	–34.2
31. ALPHATEC HOLDINGS	June 2	84	–38.9
32. COREL	Apr. 25	104	–40.3
AVERAGE FOR BUYOUT-BACKED IPOs		287	–6.0
AVERAGE FOR NON-BUYOUT BACKED IPOs		169	0.7
AVERAGE FOR ALL 2006 IPOS		203	–1.3
STANDARD & POOR'S 500 INDEX			1.0

*Through July 24

Data: Thomson Financial

CRAPS More big spenders are staying at home

SOME BETS ARE OFF

LAS VEGAS ISN'T FEELING SO FLUSH

It shows signs of a slowdown. Will what's happening in Vegas not stay in Vegas?

BY JUSTIN HIBBARD

FRENCH CHEF ANDRE Rochat started to notice around the beginning of this year. One by one, suppliers began tacking a fuel charge on to food shipments trucked or flown into Las Vegas, where he runs three high-end restaurants. The cost of items imported from Europe, such as Dover sole, rose even higher because of the dollar's weakness against the euro. To compensate, Rochat had to raise his own prices. Making matters worse, convention attendance is down 5% in Las Vegas this year because of higher airfares and hotel rates, thinning the ranks of affluent diners. "Business has slowed down," Rochat says. "Everything is changing."

Rising prices, burdensome fuel costs, flagging consumer spending—these are the gathering storm clouds that could bring slower growth to Sin City for the rest of the year. More than most cities, Las Vegas has benefited from four years of low interest rates, a sizzling housing market, and explosive growth in jobs and population. The expansion will probably continue through 2006, but at a noticeably slower pace. With its heavy dependence on housing and consumers, Las Vegas may provide some hints of what a national slowdown might look like. "The lagging impact of what the Fed has done and energy prices will cause a slowdown in the U.S. led by the consumer," warns Merrill Lynch Investment Managers president Robert C. Doll.

Signs of slackening growth in Las Vegas showed up in second-quarter corporate earnings reports. On July 25, Station Casinos Inc. and Boyd Gaming Co which run rival gambling houses cater to Las Vegas locals, reported earnings share that missed analysts' consensus timates by 3% and 19%, respectively. B companies recently opened new prop ties in the southern Las Vegas area, but far the locals' gambling market has swelled to fill the added capacity.

HOLDING BACK

THE DISAPPOINTING RESULTS adde speculation about belt-tightening amo consumers. In the 12 months ended M 31, the gambling market among locals Clark County, which includes Las Veg grew 10.4%, vs. 14.1% a year earlier, first decline in four years, according to Nevada Gaming Control Board. "I s pect we may be seeing in the locals' ga ing market some of the concerns that vestors have about the general U consumer, such as fuel prices, inter rates, and housing costs," says Matth Jacob, an analyst at independent stock searcher Majestic Research.

In Las Vegas, as in other hot mark soaring real estate prices have dri spending on cars and other consur goods. Since 2003 home price appre tion has generated more than $20 bill in paper and real wealth for residents, cording to Las Vegas economic consult firm Applied Analysis. "A lot of that m ey was pumped back into the local eco my," says Brian Gordon, a principal at firm. Although the median price of exist Las Vegas homes is still rising, the ann appreciation rate slowed to 7% in M says the Center for Business & Econo Research at the University of Nevada Las Vegas. And the number of exist homes sold in May fell 18%.

Some Las Vegas executives point that the city will add 80,000 new r dents this year, fueling more grov That's a lot of new potential gambl but it's down from a peak of 96,000 2004. Like it or not, Las Vegas see poised for a slowdown.

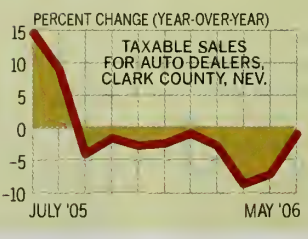
NOT AS MUCH MONEY TO BURN

As the Vegas housing market weakens...

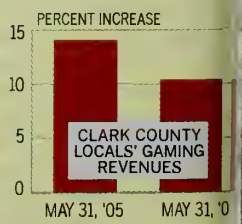
NEW HOME SALES	PERCENTAGE CHANGE
NET SALES	-39.0%
CANCELLATIONS	89.0%
UNSOLD INVENTORY	26.5%

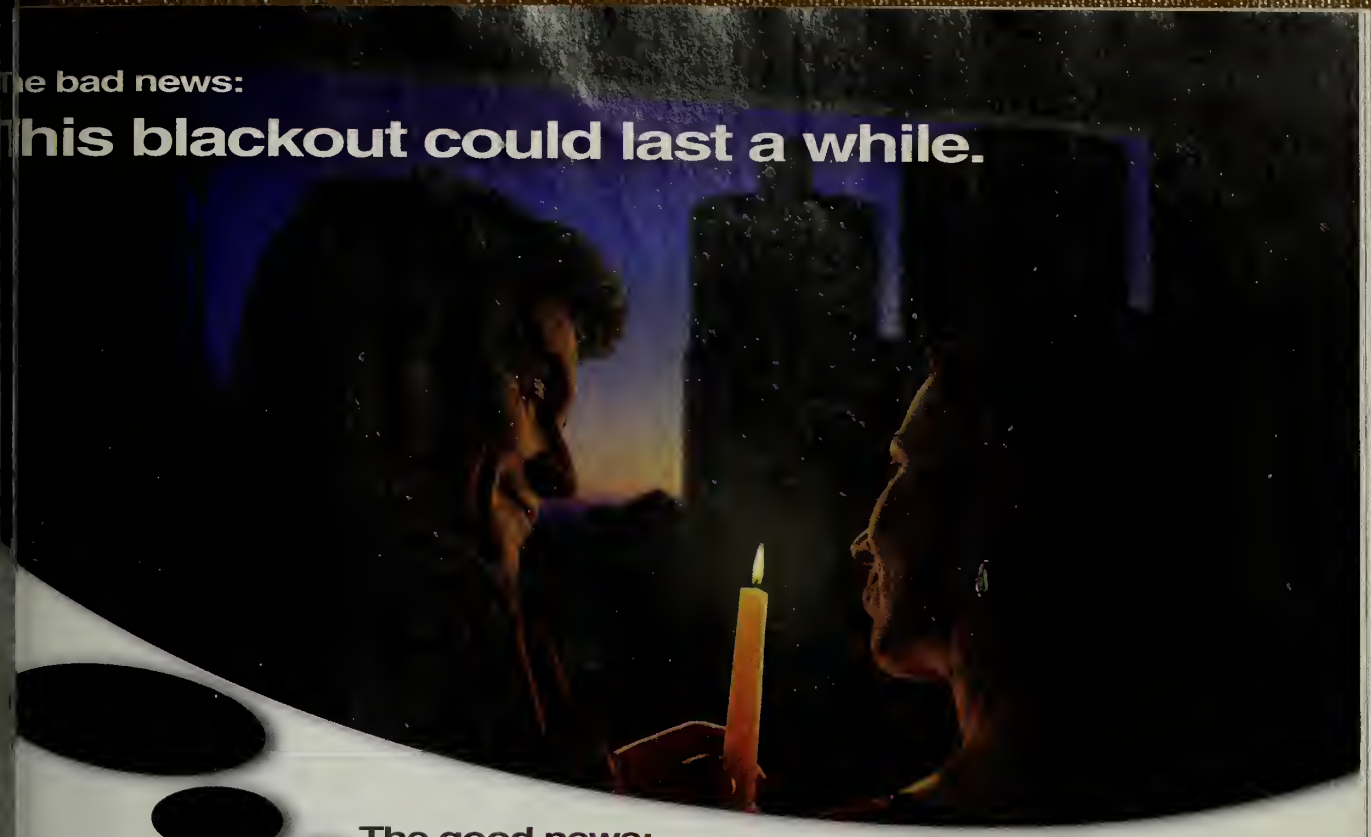
Data: Hanley Wood, Nevada Gaming Control Board

...locals are buying fewer cars...



...and gambling less





The good news:

This blackout could last a while.

Don't let erectile dysfunction (ED) hold you back from a fulfilling sexual relationship.

- Viagra is prescribed for all degrees of ED, even if it only happens once in a while.
- Maintaining an erection is important. It's just as important as getting a firm erection. Viagra can help with both.
- Viagra has an established safety profile. It's been studied more than any other oral ED treatment.

VIAGRA
(sildenafil citrate) tablets

What are you waiting for?

your doctor if Viagra is right for you. And enjoy what it can do to help you improve your sex life.

GRA is prescribed to treat erectile dysfunction. We know that no medicine is for everyone. If you use nitrate drugs, often used for chest (known as angina), don't take VIAGRA. Taking these drugs together could cause your blood pressure to drop to an unsafe level.

with your doctor first. Make sure you are healthy enough to have sex. If you have chest pain, nausea, or other discomforts during sex, medical help right away.

ugh erections lasting for more than four hours may occur rarely with all ED treatments in this drug class, to avoid long-term injuries, it portant to seek immediate medical help.

e instances, men taking PDE5 inhibitors (oral erectile dysfunction medicines, including VIAGRA) reported a sudden decrease or loss of n. It is not possible to determine whether these events are related directly to these medicines or to other factors. If you experience sudden ease or loss of vision, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

most common side effects of VIAGRA are headache, facial flushing, and upset stomach. Less common are bluish or blurred vision, or being tive to light. These may occur for a brief time. Remember to protect yourself and your partner from sexually transmitted diseases.

e see our patient summary of information for VIAGRA (25 mg, 50 mg, 100 mg) tablets on the following page.

GRA is available on most Managed Care Plans.* VIAGRA is one of several ED treatments that you and your doctor can consider.

nt of members by formulary status for HMOs, PPOs and POS for Viagra. Formulary Compass™ MediMedia USA, Inc. May 2006.

To learn more, visit viagra.com or call 1-888-4VIAGRA (1-888-484-2472)

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LAB-0220-4.0

PATIENT SUMMARY OF INFORMATION ABOUT VIAGRA®

(sildenafil citrate) tablets

This summary contains important information about VIAGRA®. It is not meant to take the place of your doctor's instructions. Read this information carefully before you start taking VIAGRA. Ask your doctor or pharmacist if you do not understand any of this information or if you want to know more about VIAGRA.

This medicine can help many men when it is used as prescribed by their doctors. However, VIAGRA is not for everyone. It is intended for use only by men who have a condition called erectile dysfunction. **VIAGRA must never be used by men who are taking medicines that contain nitrates of any kind, at any time. This includes nitroglycerin. If you take VIAGRA with any nitrate medicine your blood pressure could suddenly drop to an unsafe or life threatening level.**

• What Is VIAGRA?
VIAGRA is a pill used to treat erectile dysfunction (impotence) in men. It can help many men who have erectile dysfunction get and keep an erection when they become sexually excited (stimulated).

You will not get an erection just by taking this medicine. VIAGRA helps a man with erectile dysfunction get an erection only when he is sexually excited.

• How Sex Affects the Body
When a man is sexually excited, the penis rapidly fills with more blood than usual. The penis then expands and hardens. This is called an erection. After the man is done having sex, this extra blood flows out of the penis back into the body. The erection goes away. If an erection lasts for a long time (more than 6 hours), it can permanently damage your penis. You should call a doctor immediately if you ever have a prolonged erection that lasts more than 4 hours.

Some conditions and medicines interfere with this natural erection process. The penis cannot fill with enough blood. The man cannot have an erection. This is called erectile dysfunction if it becomes a frequent problem.

During sex, your heart works harder. Therefore sexual activity may not be advisable for people who have heart problems. Before you start any treatment for erectile dysfunction, ask your doctor if your heart is healthy enough to handle the extra strain of having sex. If you have chest pains, dizziness or nausea during sex, stop having sex and immediately tell your doctor you have had this problem.

• How VIAGRA Works
VIAGRA enables many men with erectile dysfunction to respond to sexual stimulation. When a man is sexually excited, VIAGRA helps the penis fill with enough blood to cause an erection. After sex is over, the erection goes away.

• VIAGRA Is Not for Everyone
As noted above (*How Sex Affects the Body*), ask your doctor if your heart is healthy enough for sexual activity.

If you take any medicines that contain nitrates – either regularly or as needed – you should never take VIAGRA. If you take VIAGRA with any nitrate medicine or recreational drug containing nitrates, your blood pressure could suddenly drop to an unsafe level. You could get dizzy, faint, or even have a heart attack or stroke. Nitrates are found in many prescription medicines that are used to treat angina (chest pain due to heart disease) such as:

- nitroglycerin (sprays, ointments, skin patches or pastes, and tablets that are swallowed or dissolved in the mouth)
- isosorbide mononitrate and isosorbide dinitrate (tablets that are swallowed, chewed, or dissolved in the mouth)

Nitrates are also found in recreational drugs such as amyl nitrate or nitrite ("poppers"). If you are not sure if any of your medicines contain nitrates, or if you do not understand what nitrates are, ask your doctor or pharmacist.

VIAGRA is only for patients with erectile dysfunction. VIAGRA is not for newborns, children, or women. Do not let anyone else take your VIAGRA. VIAGRA must be used only under a doctor's supervision.

• What VIAGRA Does Not Do
- VIAGRA does not cure erectile dysfunction. It is a treatment for erectile dysfunction.
- VIAGRA does not protect you or your partner from getting sexually transmitted diseases, including HIV — the virus that causes AIDS.
- VIAGRA is not a hormone or an aphrodisiac.

• What To Tell Your Doctor Before You Begin VIAGRA
Only your doctor can decide if VIAGRA is right for you. VIAGRA can cause mild, temporary lowering of your blood pressure. You will need to have a thorough medical exam to diagnose your erectile dysfunction and to find out if you can safely take VIAGRA alone or with your other medicines. Your doctor should determine if your heart is healthy enough to handle the extra strain of having sex.

Be sure to tell your doctor if you:

- have ever had any heart problems (e.g., angina, chest pain, heart failure, irregular heart beats, heart attack or narrowing of the aortic valve)
- have ever had a stroke
- have low or high blood pressure
- have ever had severe vision loss
- have a rare inherited eye disease called retinitis pigmentosa
- have ever had any kidney problems
- have ever had any liver problems
- have ever had any blood problems, including sickle cell anemia or leukemia
- are allergic to sildenafil or any of the other ingredients of VIAGRA tablets
- have a deformed penis, Peyronie's disease, or ever had an erection that lasted more than 4 hours
- have stomach ulcers or any types of bleeding problems
- are taking any other medicines

• VIAGRA and Other Medicines
Some medicines can change the way VIAGRA works. Tell your doctor about **any medicines** you are taking. Do not start or stop taking any medicines before checking with your doctor or pharmacist. This includes prescription and nonprescription medicines or remedies:

- Remember, VIAGRA should never be used with medicines that contain nitrates (see *VIAGRA Is Not for Everyone*).
- If you are taking alpha-blocker therapy for the treatment of high blood pressure or prostate problems, you should not take a dose of greater than 25 mg of VIAGRA at the same time (within 4 hours) as you take your dose of alpha-blocker.
- If you are taking a protease inhibitor, your dose may be adjusted (please see *Finding the Right Dose for You*).
- VIAGRA should not be used with any other medical treatments that cause erections. These treatments include pills, medicines that are injected or inserted into the penis, implants or vacuum pumps.

• Finding the Right Dose for You
VIAGRA comes in different doses (25 mg, 50 mg and 100 mg). If you do not get the results you expect, talk with your doctor. You and your doctor can determine the dose that works best for you.

- Do not take more VIAGRA than your doctor prescribes.
- If you think you need a larger dose of VIAGRA, check with your doctor.
- VIAGRA should not be taken more than once a day.

If you are older than age 65, or have serious liver or kidney problems, your doctor may start you at the lowest dose (25 mg) of VIAGRA. If you are taking protease inhibitors, such as for the treatment of HIV, your doctor may recommend a 25 mg dose and may limit you to a maximum single dose of 25 mg of VIAGRA in a 48 hour period. If you are taking alpha-blocker therapy, you should not take a dose of greater than 25 mg of VIAGRA at the same time (within 4 hours) as your dose of alpha-blocker.

• How To Take VIAGRA
Take VIAGRA about one hour before you plan to have sex. Beginning in about 30 minutes and for up to 4 hours, VIAGRA can help you get an erection if you are sexually excited. If you take VIAGRA after a high-fat meal (such as a cheeseburger and french fries), the medicine may take a little longer to start working. VIAGRA can help you get an erection when you are sexually excited. You will not get an erection just by taking the pill.

• Possible Side Effects
Like all medicines, VIAGRA can cause some side effects. These effects are usually mild to moderate and usually don't last longer than a few hours. Some of these side effects are more likely to occur with higher doses. The most common side effects of VIAGRA are headache, flushing of the face, and upset stomach. Less common side effects that may occur are temporary changes in color vision (such as trouble telling the difference between blue and green objects or having a blue color tinge to them), eyes being more sensitive to light, or blurred vision.

In rare instances, men taking PDE5 inhibitors (oral erectile dysfunction medicines, including VIAGRA) reported a sudden decrease or loss of vision in one or both eyes. It is not possible to determine whether these events are related directly to these medicines, to other factors such as high blood pressure or diabetes, or to a combination of these. If you experience sudden decrease or loss of vision, stop taking PDE5 inhibitors, including VIAGRA, and call a doctor right away.

In rare instances, men have reported an erection that lasts many hours. You should call a doctor immediately if you ever have an erection that lasts more than 4 hours. If not treated right away, permanent damage to your penis could occur (see *How Sex Affects the Body*).

Heart attack, stroke, irregular heart beats, and death have been reported rarely in men taking VIAGRA. Most, but not all, of these men had heart problems before taking this medicine. It is not possible to determine whether these events were directly related to VIAGRA.

VIAGRA may cause other side effects besides those listed on this sheet. If you want more information or develop any side effects or symptoms you are concerned about, call your doctor.

• Accidental Overdose
In case of accidental overdose, call your doctor right away.

• Storing VIAGRA
Keep VIAGRA out of the reach of children. Keep VIAGRA in its original container. Store at 25°C (77°F); excursions permitted to 15-30°C (59-86°F) [see USP Controlled Room Temperature].

• For More Information on VIAGRA
VIAGRA is a prescription medicine used to treat erectile dysfunction. Only your doctor can decide if it is right for you. This sheet is only a summary. If you have any questions or want more information about VIAGRA, talk with your doctor or pharmacist, visit www.viagra.com, or call 1-888-4VIAGRA.

Pfizer U.S. Pharmaceuticals

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July 2005

MPUTERS

MICROSOFT, DESIGN GURU

s pushing a sleek new hardware sion to PC makers. Will they bite?

JAY GREENE AND ER BURROWS

A HOW-TO KIT FOR THE ideal PC has been making the rounds of leading design shops. It calls for "accelerated curves" and "purposeful contrast." The preferred rs include a shade of black called Obun and a translucent white dubbed "We want people to fall in love with r PCs, not to simply use them to be luctive and successful," reads the ened booklet. "We want PCs to be obs of pure desire."

oesn't sound much like Microsoft, s it? But it is. *BusinessWeek* has ned that a team of 20 in-house deers has been working quietly for the 18 months on an elegant new look PCs that will run Microsoft's next oping system, Windows Vista. It's a maleparture for the company, which hisally has left design to likes of Dell, Hewlettcard, and Gateway. Perling the hardware guys nbrace the tool kit won't asy. They're already workovertime to build bettering gear on their own.

ut Microsoft Corp. feels PC world needs a major a-lift, and one way to do through better integrai of software and hardre. No one does that e effectively than Apple Computer, the folks in Redmond may be worried their resurgent rival is getting too h traction in the race to dominate the tal home.

hat's more, a slick new look can only the debut of Vista, which will reach sumers in January, years late and lacking many of the features it was supposed to have. "This has always been the issue with Vista: Who cares!" says Roger L. Kay, president of Endpoint Technologies Associates Inc., an industry analyst. "So they're going to try to pull all these elements together, to make [the launch] into a major event."

Microsoft is no newcomer to hardware design, of course. The company has made PC mice and keyboards for years. The Xbox game console has been a hit. Microsoft is working on a music player, Zune, that it hopes will rival the iPod. And the company routinely gins up ideas for PCs, including a small LCD screen on the outside of a laptop to display appointments and e-mail.

But trying to transform the PC ecosystem—even peripherals makers such as Logitech Inc. received the kit—takes things to a whole new level. It reflects the fact that the economics of the computer business is changing. The PC world used to be divided into two camps: those who made lucrative software and the poor schlubs who built the low-margin hardware it ran on.

> Microsoft says it's not aping Apple, just responding to demand

Apple has turned that model on its head. From the beginning it has managed to create a unified design for its products by building everything itself, first with the Mac and then later with the iPod. Although Apple sells one computer for every 20 PCs, the iPod's success has proved how crucial it is to create a seamless experience for consumers, who are buying much of the gear these days. Says a top PC design executive: "You're going to see more and more of this desire to integrate hardware and software."

Even if it means borrowing from Apple. Microsoft denies doing that, saying it's simply responding to demand for good design. Yet its approach has more than an echo of the Apple ethos. "We're decomposing the look and feel of Vista and bringing it into a language that hardware designers understand," says Steve Kaneko, design director of Windows hardware innovation. And here's another Apple-esque detail: The Zune player will work only with Microsoft's planned music service, sources say. In other words, it will be part of a closed system, like iPod and the iTunes Music Store.

SOFT SELL

SO FAR, MICROSOFT is using a soft sell with PC makers. The Windows Vista Industrial Design Toolkit, hand-delivered to about 70 designers, contains everything a PC maker needs—color palette, suggested materials, even graphics for icons and power buttons—to create computers, laptops, and peripherals that hew to Vista's look. A separate booklet exhorts hardware makers to eschew drab, utilitarian boxes. Microsoft is providing the tool kit for free and vows not to strong-arm any company into incorporating the concepts.

Will hardware makers take the hint? Those most likely to use the tool kit are upstarts with tiny design budgets and little brand identity. One is A Living Picture

PLC. The British startup plans to launch digital picture frames in October that use Wi-Fi to display photos stashed on a PC. The first two products rely heavily on the tool kit, from colors and materials to suggestions for geometry. In the end, Microsoft saved the company hundreds of thousands of dollars, says Jesse Grindeland, president of A Living Picture. "The question of using it wasn't really why," he says, "but why not."

Big PC makers such as HP, Dell, and Lenovo won't dive so deep. "This will look to [the hardware makers] like another way for Microsoft to take value from them and move it back to Redmond," says NPD Group Inc. analyst Steve Baker. "If they can't offer a unique look and feel, that takes away a lot of the value of being a hardware company."

In other words, if everyone uses the same design, a market with razor-thin margins will be further commoditized. Lenovo received the tool kit but is cool to the notion of implementing its concep "Our ability to differentiate oursel comes from our industry-leading inno tion," says a Lenovo spokesperson. "A design is a big part of that."

Trying to influence PC design is a brainer for Microsoft, since doing so co the company almost nothing. That bothering at all shows that having a s ware monopoly isn't enough anymore.

–With Steve Hamm in New Y

AIRLINES

DOGFIGHT IN DALLAS

American faces a direct threat from Southwest

CROWDED SKIES A price war is looming

BY RICHARD S. DUNHAM

AMERICAN AIRLINES Inc. is learning that even a well-connected, politically generous company can fall victim to the fickle finger of political fate in Washington.

For 27 years, the nation's largest passenger carrier held an edge at its main Dallas/Fort Worth International Airport by preserving an obscure 1979 law that prevented upstart carrier Southwest Airlines Co., then a no-frills intrastate carrier, from flying nationwide from the newcomer's home base at Love Field, which is closer to downtown Dallas. But the vagaries of power in the nation's capital, combined with airline industry turmoil, has forced American to accept a painful compromise rather than face the prospect of losing a Capitol Hill showdown with a bitter rival. "We're fatalistic about it," says American lobbyist Dan Elwell. "Let's get on with making this a better airline going forward than expending a lot of effort fighting this."

The result is something that Fort Worth-based American has vigorously resisted for decades: allowing Dallas-based Southwest to fly passengers from Love Field to any U.S. airport. The changes will be phased in. First, Southwest will be permitted to sell one-stop tickets from Dallas to the rest of the country. In eight years, the high-flying discount carrier will be permitted to fly nonstop to any domestic destination. The immediate result for travelers will be lower airfares in the pricey Dallas market. A July 12 study by two aviation research consultants estimated that 2 million North Texas airline passengers will save $259 million a year because of heightened competition.

BIG CAMPAIGN CONTRIBUTOR

AMERICAN'S PARENT corporation, AMR, which lost $861 million in 2005 amid soaring fuel costs, could feel a short-term pinch from the coming price war in Dallas. But over the long haul, company officials say the deal will allow them to focus on their core business while saving millions on lawyers and lobbyists' fees.

The 1979 law, written by then-House Majority Leader Jim Wright (D-Tex.), restricted flights out of Love Field to cities in Texas and a few nearby states. Southwest, a short-haul carrier that first turned a profit in 1973, saw the action as a political power play by American to protect its market share. American officials insisted that the measure simply wrote into law the agreement that paved the way for the creation of DFW International airport in the first place

For 27 years a string of powerful T ans, from Wright to former Republic House Majority Leaders Dick Armey a Tom DeLay, fended off repeated attem to repeal the law. As the nation's pree nent carrier, and donor of about $3.7 m lion to federal campaign coffers sin 1980, American had far more sway th its smaller competitor, whose political tion committee has given less th $400,000 to members of Congress.

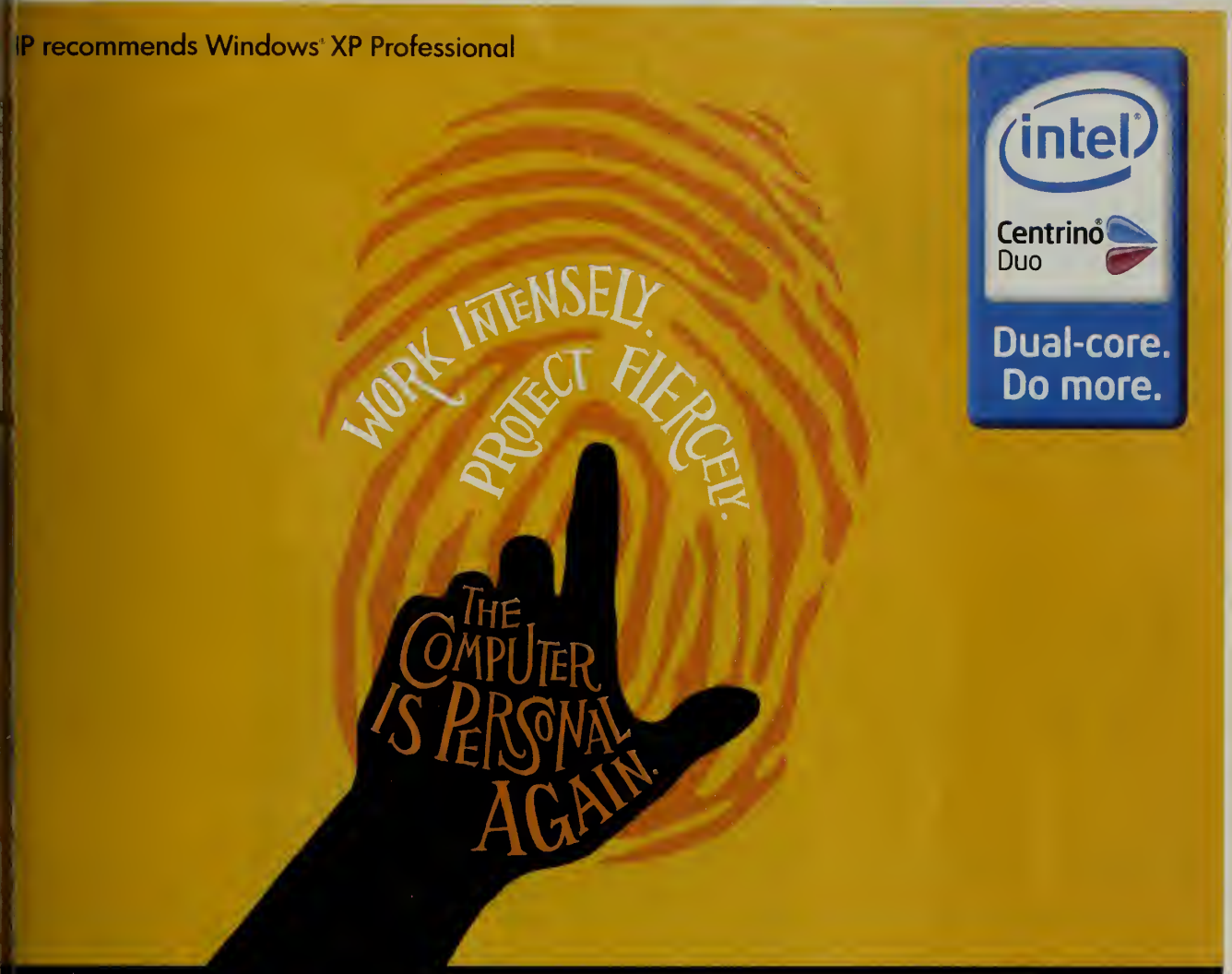
But scandals, retirements, and rec tricting have sapped the Lone Star Sta bipartisan political clout. Meanwh Southwest had completed its transfor tion from regional upstart to indus success story. And it has gone big-time Washington by hiring 16 lobbyists, cluding former Representative Tom Lo fler (R-Tex.). Moreo Southwest's "Free Lo campaign pushing for t fettered competition fr its home airfield has n onated with Hill conser tives. "Its story had sex peal to a Republic Congress," says S Coats, president of defu Dallas-based Muse "How can you arg against free market The bill is expected to p by the end of the year.

THE STAT

$861 million

Losses reported by American Airlines' parent in 2005

IP recommends Windows® XP Professional



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LAWSUITS

WHOSE VIDEO IS IT, ANYWAY?

YouTube's runaway success has opened a Pandora's box of copyright issues

BY HEATHER GREEN

WHEN YOUTUBE Inc. was sued on July 14 for copyright infringement, the shock wasn't that the video-sharing service was being yanked into court. Questions had been swirling for months about whether the upstart, which now dishes up 100 million daily videos, was crossing copyright boundaries by letting its members upload videos with little oversight. What was surprising was that it was an individual who fired the first shot—Robert Tur, an independent photographer famous for filming the 1992 Los Angeles riots—instead of a big Hollywood studio or major music label.

The dustup spotlights the role the Internet increasingly is playing in letting artists and other individuals reach out and control media. But more to the point, it shows how YouTube is evolving into a sort of eBay for video: the first place you go to find a clip, but also a place where more folks are itching to get rewarded for supplying it. A growing group of creative types is furiously producing clips, video blogs, and animated shorts with the hopes of making money through advertising or selling DVDs.

While YouTube promises huge distribution, the site and its users are just starting to sort out how to apportion the power they've suddenly acquired. Some indies are becoming wary of YouTube, which doesn't share ad dollars with them, unlike rival services. "The exposure is great, but with all the copyright issues and the lack of potential ad revenues, it seems like something that we're not going to get into right now," says Orrin Zucker, co-creator of *It's JerryTime*, a popular animated cartoon series that is shown, for now, on the artists' own site.

BOOTLEG GEYSER
When Mentos met Diet Coke

Tur's lawsuit shows the fine line that YouTube is walking as it attempts to build its business model. Tur is suing because his videos of the riot and other events were uploaded without his permission. Although lawyers agree that YouTube should be protected by copyright law as long as it responds to content owners' requests to take down their works, it entered uncharted territory when it recently began adding ads next to search results. The law prohibits a site from benefiting financially from infringement, but the company argues that it's protected since it doesn't sell ads against individual vide
Still, the courts haven't set clear bou
aries. "There has to be some way to m
money with advertising that doesn't
prive you of the safe harbor. But wh
that line is, no one really knows," s
Fred von Lohmann, a lawyer for the El
tronic Frontier Foundation.

ONEROUS TASK

MAJOR MEDIA COMPANIES are exec
ing a delicate dance with YouTube. T
17-month-old site now accounts for an
tonishing 60% of all videos watched
line. NBC and E! Entertainment
working with YouTube to promote sel
clips. And NBC has set up communi
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Grobe and Stephen Voltz to mastermin
now iconic Web video that shows th
creating intricate fountains of soda
dropping 500 Mentos into 100 2-liter b
tles of Diet Coke. The video became an
stant hit after it was published in June
Revver, a service that shares ad reven
Within days, bootlegs showed up
Google and YouTube. Voltz, a civil liti
tion lawyer, figured out the process
getting the videos removed. But as co
kept reappearing, Voltz learned that
had to keep contacting YouTube to t
down each new version.

The Mentos/Diet Coke video
seen 5.5 million times on Revver
made Grobe and Voltz $30,000.
Voltz estimates they lost anot
$30,000 to pirated copies. And for s
eral days recently, blogs buzzed with
tempts to sort out the rights of artist
control uploaded videos. As
prospect grows for making money
line, what started as a lark for man
becoming all too serious.

YouTube's Torrid Takeoff

65,000	100 million
NUMBER OF VIDEOS UPLOADED DAILY	NUMBER OF VIDEOS WATCHED DAILY

Data: YouTube

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INDIA

CALL CENTER? THAT'S SO 2004

Outsourcing shops are moving fast into higher-paying businesses

BY MANJEET KRIPALANI

AMERICANS, IT SEEMS, hate calling a help desk or customer service number to find an Indian on the line. Well, guess what, America? India doesn't particularly want to talk to you, either. As India's top companies get more sophisticated at taking over outsourced work from U.S. and European multinationals, they're finding that the lowest end of the business—call centers—just doesn't pay anymore. "Call centers have become commoditized," says B. Ramalinga Raju, chairman of Satyam Computer Services Ltd.

Like almost everyone, Indian operators dislike dealing with abusive customers frustrated by shoddy service. But more important, India's leading outsourcing shops say their U.S. corporate clients continually try to ratchet down prices, which inevitably drives down the quality of service they can provide. So lately, Indian outsourcers have begun turning down call center contracts, preferring better-paying deals for processing mortgages, handling insurance claims, overseeing payrolls, and more.

That doesn't mean India won't be doing call center work anymore. But outsourcing powerhouse Tata Consultancy Services Ltd., for instance, has turned away potential clients offering call-center-only work. "We are thinking about whether this is work we really want to do," says TCS Executive Vice-President Phiroz Vandrevala. At Satyam, just 35% of business process outsourcing employees are in call centers, down from 60% 18 months ago, Raju says. "We try to get into call centers only when it's in association with other business," says Raju. And New Delhi-based EXL Services annulled a help desk call center contract with Dell Inc. because EXL was losing money on the deal. In April, 2005, EXL asked Dell to take back that business, but it kept other contracts such as one under which EXL operators call Dell customers to remind them to make loan payments. Dell officials in India didn't respond to a request for comment.

It's all part of an ongoing assault on the bottom of the outsourcing biz. Although they're the least profitable piece of it, call centers are no snap to operate. As the industry has heated up, with multinationals and locals alike hiring by the thousands, wages have increased and qualified workers have become scarce. In many shops, some 60% of staffers quit in the first year. Worse, these problems seem to afflict call centers more than higher-level outsourcing work. "The business is a hard nut to crack," says Rashesh Shah, chief executive of Bombay investment bank Edelweiss Capital. That has led to some high-profile departures. In June, Apple Computer Inc. pulled the plug on a call center in Bangalore due to the high cost of operating in India. Two months earlier, British utility Powergen cited rising wages when it withd from a contract with call center oper Vertex Data Science.

THE STAT

35%

Share of call centers in India's business process outsourcing industry, down from 85% in 2000

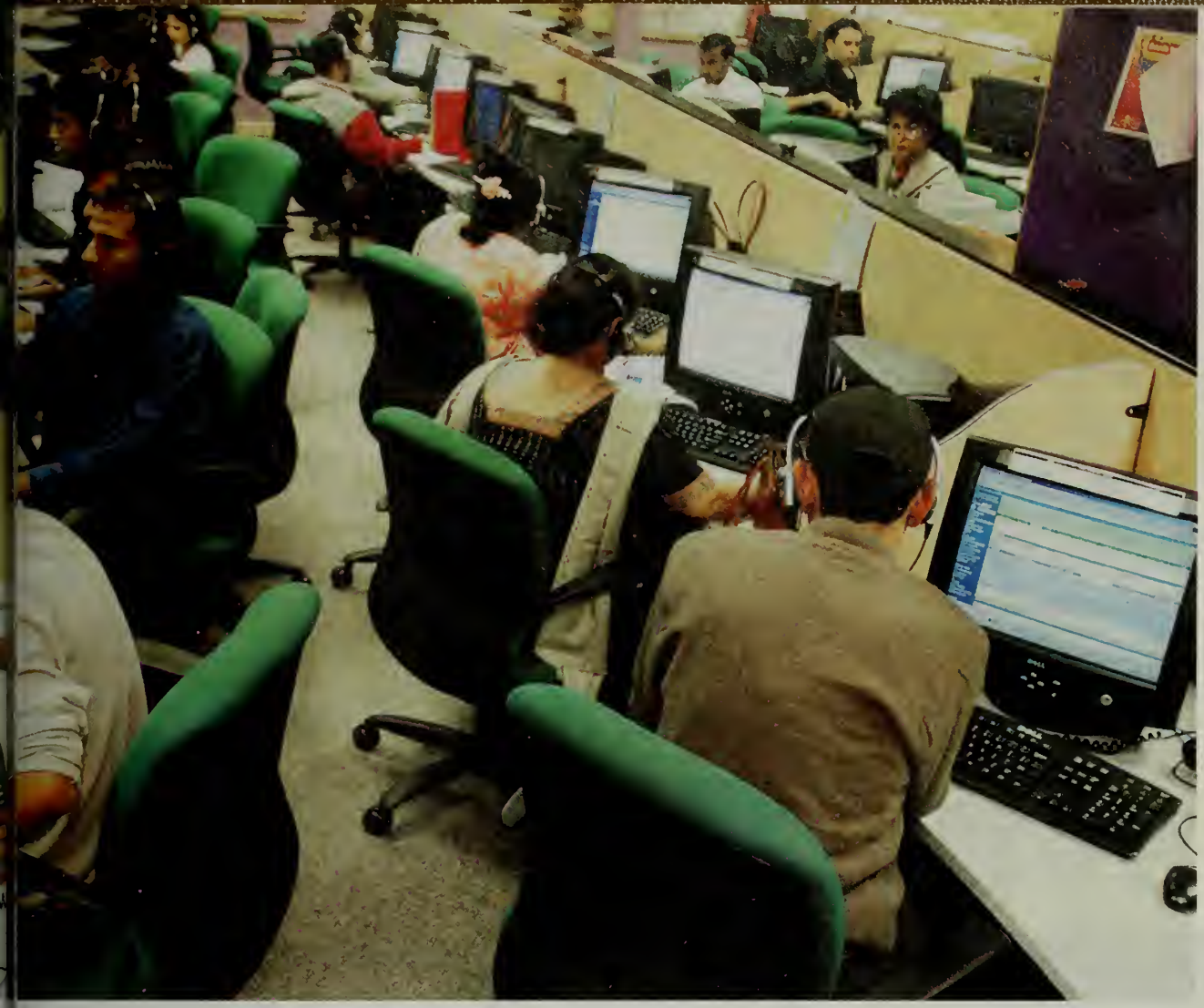
Data: National Association of Software & Service Cos

EXL It nixed a money-losing contract with Dell and now aims to go public

THE NEXT BIG THING

AS A RESULT, call centers are becomi less important feature of the Indian b ness landscape. In 2000, they represe 85% of the total back-office busin now they're about 35%, according Nasscom, India's outsourcing indu trade association. And while call cen are still growing in India, the busine expanding at about 30% annually, c pared with 60% growth for nonv back-office work, Nasscom says. "Th tellectual value of India is not at this end, but with taking large and com processes and improving them," says Kurien, chief executive of Wipro BPO

Even as the Indians become di chanted with call centers, they're gr ing ever more bullish on busi process outsourcing. The BPO indu doubled in size last year, to $6.3 bil and is expected to clock 37% an growth over the next five years, accor to Nasscom. Two new American list may give the sector an added boost.



bal Services, a former subsidiary of ish Airways that focuses on higher- BPO work, led the way with a $224 lion initial public offering on the New k Stock Exchange on July 26. One g the company won't do, though, is ch call center work. "We've always n skeptical about the call center busi- s, the pressure on margins, and the uiting and training costs," says WNS ldings) Ltd. Chairman Ramesh N. h. EXL, backed by Oak Hill Capital ners in San Francisco, is planning an for later this year as well.

he reason for the shift is simple: prof- Margins for call center work are in the double digits, but they can top 30% higher-end tasks, according to Nass- n. So Genpact, a former General Elec- Co. subsidiary spun off two years ago, fers to take on jobs that let it tap its ex- tise in analyzing zillions of bits of data help clients work more efficiently. If centers happen to be part of the equa- n, that's fine, but Genpact is reluctant ake up contracts for call centers only. e tell our clients, 'Don't start with call ters—if you do, do it together with nething else,'" says Genpact Chief Executive Pramod Bhasin. "This is harder than customers expect and needs to be handled carefully."

Other companies are following a similar path. At Hewlett-Packard Co.'s back-office operation in Bangalore, just 150 of the 5,000 employees are involved in call center work, and they're only doing jobs that specifically support the nonvoice tasks. IBM two years ago purchased Daksh, one of India's top three call center operators. When IBM bought the company, virtually all of its business consisted of call centers. Now, 40% of Daksh's work comes from higher-end business processing work. Even the call center work has been streamlined: In most cases, IBM seeks to move calls to the Web or to automated voice systems before turning the toughest cases over to a live operator. "It's no longer about cost," says Randy Walker, IBM's head of outsourcing for Asia. "Now clients want innovation and creative tools for superior performance."

Will call center work return to lower-cost areas of the U.S.? Maybe

So does this mean that call center jobs will make their way back to Peoria or Poughkeepsie? A few might. While outsourced call centers are here to stay, some are likely to migrate to locales closer to the markets they serve. That means smaller European countries, Canada, or less expensive areas of the U.S. might find some jobs returning. New Delhi's HCL Technologies and Bombay's ICICI OneSource have bought call centers in Ireland, for example. "We need global operations to be a global company," says HCL Executive Vice-President Sumit Bhattacharya. Some jobs may migrate to the Philippines, which has a close cultural affinity with America, and to even cheaper locations such as South Africa or Ghana. Many will likely stay in India with smaller outsourcing shops that are eager to snap up work that the bigger companies can afford to spurn.

–With Louise Lee in San Francisco and Nichola Saminather in New York

ITALY

BASTA WITH THE VENTI FRAPPUCCINOS

Illycaffè is the anti-Starbucks—and it's out to spread the espresso gospel to java heathens

BY GAIL EDMONDSON

LISTEN UP, STARBUCKS fans. You think you know coffee? Forget it. You don't know coffee like Andrea Illy knows coffee. The 42-year-old head of Illycaffè will tell you to use a light hand with the steamed milk and skip the caramel syrup. The really good stuff is a rich espresso that rolls over your tongue, leaving subtle hints of buttery chocolate, almonds, and fresh peaches. "Espresso is a miracle of chemistry in a cup," says Illy.

To spread the gospel and position itself as the global leader in luxury coffee, the 73-year-old family-owned company is rolling out hundreds of licensed cafés called Espressamente. That's a hill of beans compared with the 11,000 outlets flying the Starbucks Corp. flag. And the cafés are confined to Europe, Asia, and temporary locations in New York City.

Illy doesn't think the land of the Big Gulp is quite ready for his sublime, diminutive, brew. "In the U.S. coffee merely a hot beverage, not an elixir," says. But with sales of Illy beans at u scale U.S. markets such as Whole Foo and Williams-Sonoma growing at 3(annually and 7,000 U.S. restaurants a hotels brewing Illy espresso, the compa says it's only a matter of time bef(Americans will want Illy cafés.

Even so, Andrea Illy says he's not ai ing to unseat Starbucks. Instead, I game is to create an exclusive destinati with an emphasis on quality and aesth ics. The Espressamente experience will oh-so-Italiano, focused on coffee serv short and dark with perfect *crema,* foam, in a designer demitasse. Illy hoj that great espresso, combined with si roundings that ooze modern cool, v have coffee cognoscenti purring *buonis mo* with every sip. "Starbucks is l about coffee and more about commu ty," says Wendy Liebmann, president market researcher WSL Strategic Ret "Illy is about the elegance of coffee.... is elitist."

The epicenter of this coffee sophisti tion is Illy's Trieste headquarters. The beans endure 114 quality tests, with sa

eyeballed and scratched—
every bean put through a
-driven sorting machine that
ts one bean before and after
defective ones just for good
sure. Rooting out that one
bean is essential because it
poil an entire tin. That's why
ays 30% above market rates
p farmers. "We are complete-
sessed about quality—close
azy," says Illy.

LL IS BEAUTIFUL

ERFECTION. It's not easy to
tain, especially when you're
sing coffee bars from Brus-
o Beijing. To keep standards
the Illy family is taking
ge of everything from
ing the baristas to in-
r design, created by
l Italian architects
Trazzi and Claudio
strin.

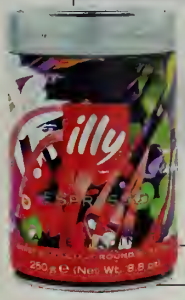
r an elite brand,
ng small is O.K. The
st-growing market
lly cafés is France,
e 20 Espressamente

JUST RIGHT? An Illy cappuccino

Espresso Expressions

A primer for cognoscenti-in-training

ARABICA BEANS Preferred for espresso. Less bitter and half the caffeine of the more common robusta beans.



COFFEE CHERRY What experts call the bright red outer covering of ripe coffee beans.

CREMA The two- to four-millimeter-thick layer of foam atop a perfectly brewed espresso.

UNDER-EXTRACTED An espresso brewed with too little heat or pressure, resulting in a *crema* that lacks body.

Data: *Espresso Coffee. The Science of Quality*, Andrea Illy and Rinantonio Viani, eds.

shops will open by yearend. The next frontier is Asia, where Illy has a venture with a Chinese partner to sell beans in 12 cities and has set up an Espressamente in Shanghai. And India's largest coffee shop chain has agreed to buy and distribute Illy coffee and machines to hotels and restaurants. Illy figures the push into new markets will help double sales over five years, to some $600 million. Profits rose 33% in 2005, to $19 million. Tiny, yes, but growing.

Illy aims to bring its cafés to the U.S. only after careful study. This fall the company will open a temporary three-floor "coffee galleria" in the Time Warner Center in New York, combining a coffee bar with art exhibits. Miami and Los Angeles could be next. "What we really need," says Illy, "is to develop coffee savoir-faire."

BusinessWeek online

For a slide show, please visit businessweek.com/extras

Meet **Mary Minnick.** She's blunt. She's impatient. And she's putting the fizz back in tired Coke.

BY DEAN FOUST

MARY MINNICK IS NOT A PAT-YOU-ON-THE-back kind of boss. She heads marketing, strategy, and innovation at Coca-Cola Co., and if ever there was a company that does not deserve pats on the back, Coke is it. "I tend to be quite discontented in general," she told investors last December. "It will never be fast enough or soon enough or good enough."

Minnick is blunt. She's also worldly and smart, with an acerbic sense of humor. She can be charming when she's not being stern. In her first year in the newly expanded post, she has brought a shock to the sclerotic complacency that has marked Coke over the past decade. "There was a culture of politeness and consensus and talking around an issue, rather than taking it head-on," she says. If Coke employees are upset by the change, too bad. "That's one thing I won't work on."

Minnick, 46, advocates a strategy that would have been heresy to legendary ex-Chief Executive Roberto Goizueta and his old, Warren E. Buffett-backed board. They turned the company into one of the world's preeminent blue chips in the 1980s and '90s by focusing squarely on soda. To Minnick, growth means more than simply boosting sales of Coca-Cola Classic. Her innovation involves more than repackaging existing beverages in slightly different flavors. Minnick is exploring new products as far afield as beauty and health care. If she accomplishes even half of what's on her drawing board, she'll usher in the greatest flowering of creativity in the company's history. And should her plan succeed, she could end up CEO, if not at Coke then almost certainly elsewhere (Target Corp. has already put her on its board). Either way, Coke will end up a dramatically different company.

Coca-Cola is an American icon, yet it is in danger of slipping into irrelevance. Consumers are flocking to a new breed of coffees, juices, and teas—all categories where Coke has historically been weak. For the longest time, Coke seemed in denial, more fixated on reversing the stagnation in soda than investing in the alternative beverages that consumers were clamoring for. Archrival PepsiCo Inc. has eclipsed it in many important ways, including stock performance, earnings growth, talent development, and buzz. Even though Coca-Cola still racks up more annual profit than Pepsi, Pepsi now has a market value, $103 billion, virtually equal to Coke's. Just 10 years ago, Coke was three times bigger.

Now, Coke is at a turning point. On the one hand, it is still the most valuable brand in history, according to consultancy Interbrand, which measures how much a company's brand drives its

PHOTOGRAPHY BY BRAD TRENT; DIGITAL IMAGING BY DAVID RUDES/BW

en of Pop

sales and profits (page 60). On the other hand, the value of the Coke brand has declined 20% since 1999, to $67 billion, according to Interbrand. That's one of the largest percentage drops of any multinational during that period. The challenge of reversing this trend, of making Coke more exciting, innovative, and relevant, falls largely on Minnick's shoulders. The marketing dynamo has helped bring a new sense of urgency to everything, from how the company advertises (one of her first moves was replacing Coke's lead agency, Berlin Cameron & Partners) to how it develops new drinks. "She did not look to me like the other leaders at Coca-Cola. She looked like someone I would have met at GE," says Jeff DeGraff, a University of Michigan business professor who has consulted for Coke.

Minnick's top priority has been jump-starting Coke's product development. Under her leadership, Coke has been unusually prolific, launching more than 1,000 new drinks or new variations of existing brands worldwide in the past 12 months, including a new male-oriented diet drink called Coca-Cola Zero as well as a brisk-selling coffee-flavored cola called Coca-Cola Blak. But Minnick knows that, in the long run, new flavors and brand extensions won't be enough to make Coke a growth company again. So with the solid backing of CEO E. Neville Isdell, to whom she reports, Minnick is pushing to transform Coke from a soda-centric organization that was long content to offer "me-too" products in emerging categories to one on the cutting edge of consumer trends.

Hip

To burnish its image with urban trendsetters, Coke is rolling out a collection of **designer aluminum bottles** with etched graphics that glow in the dark. Not available in stores, the bottles are being distributed in roughly 60 fashionable nightclubs around the world.

At a private, mid-May meeting of Coke's top 200 global marketers in Istanbul, Minnick implored her troops to stop thinking in terms of existing drink categories and to start thinking broadly about why people consume beverages in the first place. The goal: to come to market with products that satisfy those needs before the competition. To that end, Minnick loves to talk about what she considers the 10 primal "need states" that consumers have, including "hunger and digestion," "mental renewal," and "health and beauty." Creating drinks that meet each of those need states may mean inventing entire new categories. Imagine drinks, for example, that are fortified with vitamins or nutrients and provide women the same benefits as a facial scrub or cold cream.

Healthy

Selling tea in China is a tough business for outsiders. So Coke positioned its entry, **HealthWorks,** as a wellness brew: HealthWorks is infused with traditional Chinese herbs such as chrysanthemum flower and myrobalan, a prune-like fruit loaded with antioxidants. Coke hopes to bring more such wellness drinks to the U.S. in the future.

In the future, Minnick says, the winners will be those beverage companies that develop breakthrough products that, more often than not, cross over traditional beverage categories—just as Red Bull did when it single-handedly created the energy drink segment. "Like Henry Ford said, 'If I'd asked the consumer what they wanted, they'd have said a faster horse,'" she told her staff in Istanbul.

To be sure, some of what currently emerging from Coke are catch-up products that finally give it an entry into some hot categories. The Atlanta behemoth just launched a new bottled tea called Gold Peak, and in coming months it'll unveil a premium coffee drink licensed

Coke's New Attitude

n chocolatier Godiva to compete with bottled Frappuccinos
l by Pepsi in a venture with Starbucks. And Coke is using new
kaging to help reinvent some of its older brands, including the
ship Coca-Cola Classic. Earlier this year, the company began
ing out sleek, aluminum designer Coke bottles with etched,
w-in-the-dark graphics, for sale initially in a few dozen night-
os around the world. The hope is that the designs will improve
120-year-old brand's image with trendsetters.

ig Ambitions

T THESE ARE SMALL VICTORIES, and Minnick knows that.
he Istanbul conference, the morning after a feel-good open-
speech, she gave her staffers a cold-water wake-up call in
form of a rugged market-
critique. She was rapid-
, speaking quickly but
rly from a dais to her 200
ops: "I don't think we've
led the diet and light cat-
ries. I think our con-
ner insights are too su-
ficial," she said. "We
d to refine the Fanta vi-
n. It's got to be more than
nta fun.' It didn't grow as
as it could last year."
Such frank appraisals are
tage Minnick. She may be
sque, but her staffers say
t as a veteran of Coke,
nnick has the clout and
itical savvy to make sure
gs happen. Coke's chief
ative director, Esther Lee,
es that while some previ-
chief marketing officers
ggled to get Coke's country managers to adopt a new global ad campaign, with Minnick's backing she had no trouble getting buy-in for the new "Coke Side of Life" campaign. "I could not have done a global campaign before Mary," says Lee.

Minnick's bigger ambitions, if they take hold, would utterly redefine Coca-Cola's image as a purveyor of sugar-laden junk that you shouldn't give your kids. Based on prototypes that *BusinessWeek* saw in Istanbul, look for "nutraceutical" versions of Diet Coke, or new juices designed to help women with skin care, weight management, and detoxification. In the past year, Coke has launched 18 clinical trials to test the health benefits of different new ingredients that it hopes to use in future drinks. In Japan, Minnick's former stomping grounds, Coke is already selling some of these very products. As one of Minnick's top lieutenants, Penny McIntyre, told marketing staffers at the Istanbul summit: "It's not far away that not only can you feel better but you can look better through healthy beverages. We are going to transform our beverages and, along the way, transform the company."

That's a stirring vision, but one fraught with challenges. For one, drinks that make health claims could require government approval. An ever bigger challenge may be winning support from the company's vast network of independent bottlers. Rather than dumping finished product on the bottlers, as her predecessors did, she's engaging them as products are being conceived to ensure their input and cooperation. "There are a lot of bottlers who realize now that

Indulgent

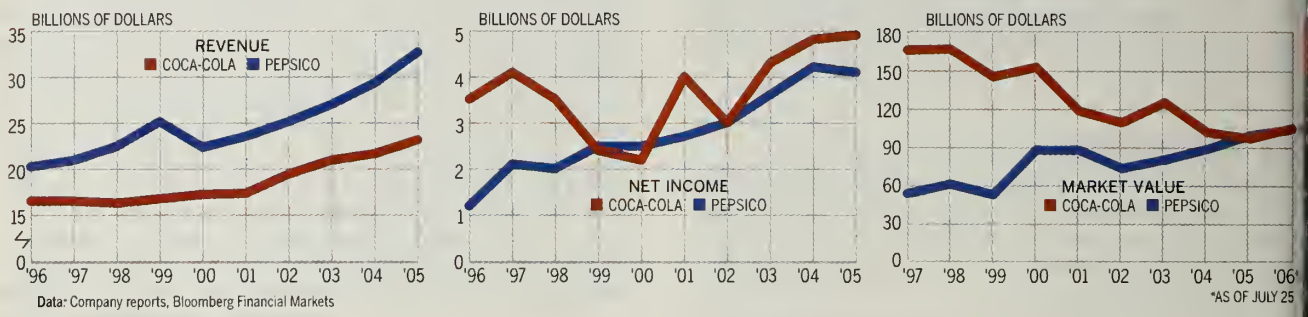
The old Coke essentially ceded the bottled coffee category to PepsiCo, which sells Frappuccinos in a joint venture with Starbucks. Under Minnick, Coke plans to fight back in coming months, launching **Godiva,** a line of decadent mochas and lattes produced under license from the chocolatier.

Upscale

Long known for the flagging Nestea line, Coke is going upmarket with **Gold Peak,** a new premium tea. It's lightly brewed to cater to the palates of the 30-and-over set. The tea has already hit New York and the Hamptons, and goes nationwide soon.

Investors: Switching to Pepsi?

Pepsi has higher revenue and steadier profit growth than Coke, and its market value now virtually matches its archrival



Data: Company reports, Bloomberg Financial Markets

it's innovate or die," says Ron Wilson, president of a large Coke bottler in Philadelphia.

Minnick's role as corporate agitator may appear surprising, given that she's a Coke lifer. But she was pushing "non-carb" beverages—Coke parlance for anything that isn't a carbonated soft drink—back when doing so was career suicide. Not coincidentally, perhaps, she made her name far from Atlanta headquarters. As head of operations in Japan and, in time, all of Asia, she sold canned coffees, teas, and vitamin drinks in cultures where soda is an acquired taste.

While Minnick gets plenty of attention these days, she doesn't necessarily crave the spotlight. Minnick grew up in rural Nova, Ohio, a town so small it had no stoplight and just one stop sign. From the age 13, she spent summers working on her father's golf cour mowing fairways, raking sand traps, and flipping burgers in t clubhouse. Minnick helped pay her way through Bowli Green State University in the late '70s by slinging hash in t student cafeteria. ("There I am trying to look cool for this cu guy when I'm wearing a hairnet and an orange polyester ur form," she laughs.)

She earned an MBA from Duke University in 1983, and sta ed her career on the bottom rung of the Coke ladder, as a sal rep in its fountain division. "My job was figuring out how to s more beverages to a hot dog chain in Minneapolis in Janua driving a car with 150,000 miles on it, living in a one-bedroo apartment in a horrible part of Atlanta, and questioning t meaning of life," she recalls.

Brands that Span the Globe

Building the Most Valuable Brand: A photo slide show illustrates 120 years of Coke ads.

Best Global Brands: Interactive rankings from *BusinessWeek* and Interbrand.

Sharpen Your Pencil: How well do you know your brands? Take our online quiz and find out.

Listen In: Executive Editor John A. Byrne's podcast interview with writer Dean Foust.

BusinessWeek online

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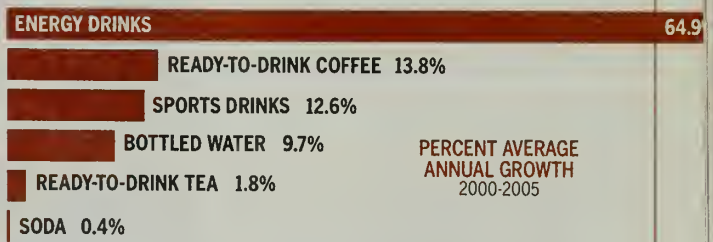
"Wolf Sweat"

MINNICK DID WELL ENOUGH to earn a promotion into Coke vaunted marketing department. In time she convinced ma agement to let her lead a new team being formed to devel new drinks to counter emerging non-carb rivals such as Sna ple and Gatorade, which were starting to steal customers fr Coke's soft drink business. Given Coke's soda-centric culture was a lonely vigil. When Minnick and her team developed clear beverage called Nordic Mist to take on a new rival dri called Clearly Canadian, some senior Coke execs derisively r ferred to it as "Wolf Sweat." Says Minnick: "I walked into a se ior manager's office in [Coke's] North America [division]—a

SANISH BOTTLER
Carbonated, coffee-flavored Coca-Cola Blak is selling briskly

Coming Up Flat

Sales of soda—Coke's signature product—have been stagnant as new beverage categories have captured consumers' attention



Data: Beverage Marketing Corp. of New York, *BusinessWeek*

I won't tell you who, but he was very senior—and he said, 'Mary, every case of Powerade and Nordic Mist I put on the truck, I have to take a case of Coke off. That doesn't pay off.'"

Similarly, when Minnick's team created Fruitopia to take on Snapple, bottlers balked at the expensive glass bottles and its more expensive brewing process. Against Minnick's wishes, management buckled, ordering a switch to plastic bottles and the same "cold fill" process used to make soda. Those two changes served to cheapen the product in the eyes of consumers and, with sales faltering, Coke eventually pulled Fruitopia from the U.S. market.

Over time, fighting battles against recalcitrant senior executives who didn't see a future outside of soda came at a cost to Minnick. "One of the senior managers of the company said to me, 'You've pushed too hard, you've alienated everyone in North America, your passion for non-carbs has gotten in the way of what's right for Coke, and nobody wants to work with you anymore,'" she remembers. Dejected, Minnick took the LSAT and applied to law school.

But her spunk and resourcefulness hadn't gone unnoticed by Sergio Zyman, who had returned to Coke in 1993 as head of marketing. He persuaded her to stay and provide marketing support to Coke's Asian operations. By 1997, Minnick found herself being shipped overseas to run the company's South Pacific group, covering Indonesia, Australia, New Zealand, and all the Pacific Islands.

Almost immediately, the Asian economic crisis crippled the region and Coke's business there. With currencies plunging and violence rising, Coke's Indonesian bottler pleaded with Minnick to simply shut down operations in that country until after the crisis passed. But Minnick refused, opting to ride out the storm even though that meant evacuating Coke employees on two different occasions during ensuing riots. The company emerged from the crisis even stronger. "It was a great success story. We got credit from the [public] for staying," she says.

Proving Ground

AS HER REWARD, in early 2000 Minnick was named to head up all operations in Japan, which had historically generated 20% of Coke's profit until a slump in the late '90s. Minnick's full-frontal management didn't set well with the Japanese male staffers at Coke's local headquarters in Tokyo, some of whom complained privately in letters to then-CEO Douglas N. Daft in hopes of having Minnick reassigned. Daft's response to the instigators: "This woman will be there longer than you. She has my full support." Still, Minnick now admits that she had to dial back because bottlers already had begun swapping "Mary Minnick stories." "I think I started to temper my management style in Japan," she acknowledges. "Because of the culture, you have to learn patience and a certain sense of decorum. They don't appreciate anger and displays of emotion." She slashed operating costs, invested in state-of-the-art vending machines popular with Japanese teens, and after two years of flat-to-declining revenues, sales began to grow between 2% and 4% a year. That earned Minnick another promotion in 2002, to

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Sun microsystems share

head up all of Coke's Asian operations.

Japan was a crucial period for Minnick. It was the first real test of her leadership ability. And it was the place where she realized the full potential of non-carb drinks, which are now a fundamental part of her turnaround plan for all of Coke. In most of the company's markets, Coke Classic is the cash cow. But in Japan, the company generates the bulk of its profits, surprisingly, from canned coffees and 200 or so eclectic products like Real Gold, a hangover cure sold in a small bottle, and Love Body, a tea marketed to calorie-counting women (and which contains an ingredient that some Japanese believe increases bust size). Coke's marketing team in Japan knew how to ride the trends, introducing as many as 100 new products a year, some with a life expectancy of just a few months. Thanks to constant data reports from 7-Eleven stores, "we knew within the first four weeks if we were going to be in trouble or not," she recalls.

TEA IN TOKYO A shopper picks one of Coke's many Japanese products

While Minnick was helping get Asia back on track, all was not well with the rest of Coke. It had overinvested in some emerging markets, and soft drink sales had flattened. Daft (who is on the board of The McGraw-Hill Companies, *BusinessWeek*'s parent) resigned in 2004 under pressure from the board, which brought in Isdell. From the moment he arrived, Isdell preached the need for Coke to become more aggressive in selling alternative beverages. He spent an additional $400 million a year to boost marketing and fund new product development. And as he held a series of management retreats to lay out his vision, he became so impressed with Minnick's i tellect that he approached her on a Friday morning in Ma 2005, to become head of marketing.

"Plan, Plan, Plan"

SHE TURNED HIM DOWN on the spot. "I had spent 10 years li ing in Asia, and I loved it—the people, the culture, the way of li ing." But Isdell persisted in a second meeting that same day. A ter she spent a weekend soul-searching, Minnick's boyfrien Simon Cooper, who owns a fly-fishing tour service in Britain, e couraged her to take the job and "give it a year." Minnick reler ed, but only after Isdell assured her of his full backing to overha Coke's marketing. Minnick knew all t well that Coke had talked the talk about i novation but little had really happened.

Once back in the U.S., Minnick didi bother ingratiating herself with her sta First, she laboriously analyzed Coke's pe formance over each of the past 10 years a produced a "look in the mirror" report th assessed the company's marketing mov both good and bad, during that period. S brought in management gurus like Ra Charan and Michigan's DeGraff. Reca DeGraff: "When I got to Coke, they liked draw up PowerPoint slides, and they lik to plan, plan, plan. They were very slow."

In what must have been a humbli act for a company that had been consi ered one of the preeminent growth m chines during Goizueta's glorious reig Minnick dispatched top aides to comp nies like British Petroleum, Apple Cor puter, and Kraft to study how those cor panies approached innovation. "V asked ourselves, 'How can we do it in Apple way? It's the way they did it in 'Think Different' way." By contrast, t much of what passed for innovation Coke over the years had been increme tal line extensions that too often didi

BIO

Mary E. Minnick

She has gone from waitressing in the bar of a Holiday Inn to serving up a turnaround strategy for the world's beverage leader

TITLE President of marketing, strategy, and innovation.

BORN Nov. 27, 1959, in Evanston, Ill. Father was a salesman who bought and ran a golf course; mother a schoolteacher.

EDUCATION BS, 1981, business, Bowling Green State University. MBA, Duke University, 1983.

FAMILY Dating Simon Cooper, owner of a fly-fishing tour service in Britain.

EARLIEST JOBS Mowing fairways on her dad's golf course, tutor for the blind, cocktail waitress at a Holiday Inn.

CAREER PATH Sales job in Coke's fountain division, then worked on team developing Coke's first "non-carb" products like Fruitopia and Nordic Mist, both of which were pulled from the U.S. market. Established herself in the company as a manager in Coke's Asian unit, rising to become president of the division in 2002.

LAST BOOK READ *Digging to America* by Anne Tyler.

WHAT'S IN HER iPOD Classical, Motown, Black Eyed Peas.

QUOTE "I would say I have a rather impatient sense of urgency on just about everything."

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PLAYBOOK: BEST-PRACTICE IDEAS

Mary's Makeover

ow she's overhauling Coke's marketing machine

nticipate the ustomer

ke has always thought in terms traditional drink categories like la or juice. In the past, novation meant incremental line tensions such as new flavors. **t Minnick wants Coke's arketers to think more creatively out consumers' needs.** That has l Coke to consider creating nks that cater to, for example, e desire to feel healthy.

Retool Tired Brands

The cost of launching a new brand can be prohibitively expensive. **So while Coke is creating some new brands, it is also repositioning existing ones in categories where it's behind.** In the U.S., Coke dusted off the Tab brand to create an energy drink for women, and it's using the Sprite name for a new energy beverage in France.

Engage Partners

Coke's independent bottlers have long resisted the company's efforts to launch niche brands, refusing to carry some new products that they deemed low volume. **So Minnick has been bringing its bottlers into the decision-making process to get their input—and, Coke hopes, get them on board—from the outset.**

Don't Fear Failure

Coke has a history of planning and then planning some more—with the result that many new products never made it out of the lab. But as head of Coke in Japan, **Minnick perfected the art of putting new drinks out on the cheap and then using quick feedback from retailers to determine which new drinks were resonating with consumers.**

y move the needle. "You ended up having a single flavor ge—a Key lime Fanta—and not transformational innova- " she says.

ilture of Candor

E'S GENTEEL Southern ways meant managers talked nd problems, but Minnick tried to instill a culture of ac- tability in the marketing department and with the compa- ad agencies. Minnick doesn't apologize. "Historically, we a culture where putting the hard issue on the table made people uncomfortable," she says. Some former Coke mar- g executives praise Minnick for raising the bar. "It's a com- full of belongers with not enough performers," says Zy- , who served two stints as chief marketing officer during the s and '90s. "She has been right to try to shake things up."

ne of the first things that Minnick shook up was advertis- Over the decades, Coke was known for creating some of the test ads ever. A 1971 commercial jingle, *I'd Like to Teach the Vld to Sing*, became a peace anthem during the Vietnam War. since the late '90s, Coke ads have been mostly forgettable. in days of taking the job, Minnick began killing ads left right, including one somber, European ad that showed an- teens clanging Coke bottles against light posts as they ned the streets and gathered at a cliff. Before it was over, Minnick fired Coke's lead agency, Berlin Cameron & Partners, and initiated an agency "shootout" that led to the selection of Portland (Ore.)-based Wieden + Kennedy, the masterminds behind Nike Inc.'s "Just Do It" campaign. Agency President Dan Wieden, who had handled small assignments for Coke for nearly a decade, admits that he took the new assignment with some trepidation. "The layers of bureaucracy at Coke prevented you from doing good work. They had a huge reliance on [focus group] testing. And people would make decisions based not on what was in front of them, but would try to second-guess what people above them might think."

But Minnick's new team, led by creative director Lee, gave Wieden carte blanche. The result, the "Coke Side of Life" campaign unveiled earlier this year, was hailed by ad critics like *Chicago Sun-Times* columnist Lewis Lazare, who credited the spots with putting Coke advertising "gloriously back on track." Katie Bayne, a senior vice-president who oversees Coca-Cola trademark products, notes that four of the new commercials, including one where a young male repeatedly steals sips from a soda fountain while the clerk isn't looking, ranked among the highest-scoring Coke commercials ever in independent consumer testing. That's good news, but people who work for Minnick know better than to bask in the momentary glory. "She's not one to celebrate," says Lee. "We don't spend a lot of time talking about why something is good."

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Best Global Brands

How the BusinessWeek/Interbrand Top 100 companies are using their brands to fuel expansion

BY DAVID KILEY

NOT LONG AGO, MOTOROLA SAW ITSELF THE same way its customers did: as a tech-driven seller of products, not a brand. The success of the RAZR changed all that. By ringing the consumer's bell, the hot-selling mobile phone validated a new strategy, internally dubbed MOTOME. Suddenly Motorola was a company that had rediscovered its identity as a major consumer brand.

The key, says global marketing head George Neill, who came to the company last year from Apple, was to think of the brand as providing experiences to consumers, not just hardware. "We're focused on giving access to what people want—music, video, Internet—wherever customers roam." That translated into an 18% gain in the company's global brand value on this year's *BusinessWeek*/Interbrand Annual Ranking of the 100 Top Global Brands. The phonemaker, adds Interbrand Group CEO Jez Frampton, is "redefining the place people make for the Motorola brand in their lives."

This year's list is brimming with hot brands such as Motorola that are crafting new and surprising ways to branch into entirely new product arenas. Hyundai is launching a premium sedan. Google is wading into selling ad time on the radio. Others are revving up their brand's goodwill value to dodge problems, as McDonald's is doing with its health and fitness marketing to counter concerns about junk food.

Every company wants its brand to get bigger. The hard part is balancing what the brand is with a vision of what it would like to be. "As soon as you try to go someplace that doesn't fit or where you don't have credibility, it can detract from your organization and your brand," says Frampton. The sixth annual *BusinessWeek*/Interbrand rankings measure an elusive but crucial quality. Companies that score high can count on plenty customer loyalty as they push into risky expansions.

Don't Fear Public Flops

THE GOOGLE NAME is stronger than ever: In this year's ran ing it gained 46% in brand value—t biggest year-over-year rise of a company ever on the list. Revenu climbed by 105% last year. With ma ket share in Internet search still sur ing, it can afford to gamble with i universally recognizable brand.

That allows Google to launch slew of new products with small investments, gain valuable us input at early stages of development, and in turn challenge ma ket leaders such as Microsoft in mature businesses. "The w you find really successful innovation is to release five things a hope that one or two of them really take off," says product cz Marissa Mayer.

When your brand is a verb in the *Oxford English Dictiona* you can weather the sting of a few product flops. In the proce you can harness the power of early releases, when users ofi tons of suggestions, and engineers can fold in upgrades a adapt on the fly. That's what the company did with Goog Video, which was expanded to let people upload and showca their own creations. Another example: When Google initia launched Gmail in 2004, it scared some would-be customers scanning e-mails for keywords and serving up ads relevant their content. Since then the company has invited Web criti and consumer advocates to weigh in during the test phases other new offerings.

The Big WINNERS

Google posted the biggest single-year percentage gain of any company in the rankings' five-year history. Growth at eBay, the top dog of 2005, slowed from last year.

BRAND	2006 BRAND VALUE (BILLIONS)	2005 BRAND VALUE (BILLIONS)	CHANGE IN BRAND VALUE
GOOGLE	12.38	8.46	46%
STARBUCKS	3.10	2.58	20
EBAY	6.76	5.70	18
MOTOROLA	4.57	3.88	18
HYUNDAI	4.08	3.48	17

The Big LOSERS

Practically every industry had a loser this year. Gap slipped 12 places in the rankings, and beleaguered Ford made its fifth appearance on this list, falling eight places.

BRAND	2006 BRAND VALUE (BILLIONS)	2005 BRAND VALUE (BILLIONS)	CHANGE IN BRAND VALUE
GAP	6.42	8.19	-22%
FORD	11.06	13.16	-16
KODAK	4.41	4.98	-12
HEINZ	6.22	6.93	-10
INTEL	32.32	35.59	-9

Data: Interbrand; JPMorgan Chase; Citigroup; Morgan Stanley

oogle's brand may not always ride this high. Failed product e s can pile up and dent all the positive brand buzz. That's a very, particularly since only a few of its services beyond search ae found real acclaim, much less significant new revenue. till, the company has a toehold almost everywhere and a rck for speed. In the past year it has launched an online fi-ace site, a spreadsheet tool, and a word processor, and it las to resell radio and TV ad time to its ad clients. Several of he may never be big cash machines, but with revenues grown 77% last quarter, it's hard to blame Google for failing in ll ways when it's winning so big on the Street.

ce Your Weaknesses

N THE FIVE YEARS leading up to 2003, Donald's saw its market capitaliza-ic fall by $12.2 billion. And this is no rnet stock. The problem was that de-pe the company's nearly 100% brand reness in every global market, the l images of Ronald McDonald weren't ring well. Just as troubling, evidence va mounting that junk food was fuel-an obesity epidemic in the U.S. Mc-Donald's had long struck a defensive pose against such barbs. But it was time to take control of the brand before outside forces did it for them.

McDonald's discovered that while its big-budget Disney tie-ins and Olympics sponsorships kept the Golden Arches in kids' sights, mothers were its real problem. Opinion studies and focus groups showed a mounting distrust of McDonald's and guilt among suburban moms about letting kids eat there. "Everything we do is really driven through the eyes of our customers and understanding what their needs and desires are," says Global Chief Marketing Officer Mary Dillon.

So the chain set out to appeal to moms. In the past three years, one-third of its 13,725 restaurants have been upgraded, and new premium-priced salads and chicken meals have been added. Fruit offerings such as apple slices have helped change Mickey D's image—it's now the nation's biggest wholesale buyer of apples. This year, McDonald's global brand value rose a healthy 6%, and its market capitalization grew by $2 billion. The company took the mom-friendly message to a new level last February. McDonald's kicked off a global campaign tied in with the Olympics that talks up the importance of exercise and nutrition, using such athletic role models as tennis stars Venus and Serena Williams.

The campaign ("It's what I eat and what I do...I'm lovin' it") includes TV ads, new packaging, and a series of Ronald McDonald videos teaching children how to eat well and stay active. Meanwhile, average restaurant sales are up to a record $1.9 million thanks to the premium-priced items. Says Dillon: "One of the fun things about McDonald's is we are always learning about how we can expand our brand."

Earn Permission to Grow

IN 1998, HYUNDAI'S reputation in the U.S. was so ravaged by a decade of quality problems that the South Korean company considered pulling up stakes. Chung Mong Koo took over that year and began reinventing how Hyundai viewed quality. A carmaker without a U.S. presence, he reckoned, could never be a global brand.

Quality improved, but Hyundai was still far behind. So Chung devised an aggressive strategy: Until at least 2008, Hyundai models would carry a 100,000-mile/10-year warranty to give customers peace of mind. This created hundreds of millions of dollars a year in extra provision costs, of course. Meanwhile, Chung ordered plant managers to obsess about quality, even to stop production lines if defects were detected. The practice was common in Japan and catching on in the U.S. but still unheard of in Korea.

The moves paid off. In the U.S., Hyundai saw its sales grow from less than 100,000 in 1998 to 455,012 last year. Global brand value climbed an impressive 17% last year. In the latest quality scores from J.D. Power & Associates, released in June, Hyundai was the top-rated nonluxury brand ahead of Toyota. That now gives Hyundai the street cred, for example, to sell its new Azera sedan, which costs close to $30,000 and has been compared seriously to the Chrysler 300, Toyota Avalon, and Buick Lucerne.

Having earned stripes from critics, Hyundai says it's looking for more creative validation as it contemplates a sub-brand to compete with Lexus and Cadillac. "One important objective of our brand is to create emotional connection with our clients," says Nam Myung Hyun, general manager for brand strategy. It shouldn't be too hard. Americans love an underdog, especially one that has learned new tricks.

Make Simplicity King

WHEN GERARD KLEISTERLEE took the helm of Royal Philips Electronics in 2001, the Dutch conglomerate's empire included TVs, lighting, medical devices, and semiconductors. The missing key: a coherent brand. "We had to choose whether Philips was a company built around its core technologies or one built around its core brand," says Kleisterlee, who presided over a healthy 14% gain in global brand value last year.

He wisely chose the latter. In doing so he had to shake up the way the company thought about customers and communication without alienating the engineering and science units critical to innovation. In 2004 its "Sense and Simplicity" global branding effort launched. The idea is to create a "health-care, lifestyle, and technology" company that offers easy-to-use products designed around the consumer. To get the effort on track, the CEO created an internal think tank, the Simplicity Advisory board, comprised entirely of Philips outsiders: a British fashion designer, a Chinese architect, an American radiologist, and an American Massachusetts Institute of Technology professor.

The board looks at overarching questions like: How does simplicity get executed? Their strategic advice changed the way the company thinks, leading to a series of new, user-friendly products. It wasn't enough to design a small defibrillator that could be stashed in public spaces such as airports and workplaces. Consumers dictated that it be the size of a laptop and simple enough that the untrained could spark a heart back to life in seconds using built-in audio instructio There's also Perfect Draft, a home draft-beer di penser that's a twist on Philips' hugely successf Senseo coffee machines.

Philips installed new test centers around t world where products are extensively critiqued consumers. That saved the company from flubbi the launch of its WACS7000 Wireless Music Center & Statio which it postponed when the software was rewritten because complaints of overcomplexity.

Brand value hasn't come cheaply for Philips. Analysts say t company spent $170 million in 2005 and plans to invest arou the same amount this year on the new campaign. But Kleist lee knows the company's future valuation depends on t strength of the brand: "Everything we do, from our products the way we work with our suppliers and customers, has to li up to the simplicity promise."

Protect Your Culture

STARBUCKS HARDLY advertises, instead relying on its ubiquitous cafés to do the talking and create its 20% bump in global brand value. That means keeping them free of the clutter of other brands and products, which are constantly trying to piggyback on the Starbucks aura and access to 30 million weekly customers. At the same time, the chain has come to view its brand as a kind of cultural portal—after co-producing a series of music CDs, Starbucks this ye backed a book and a film. So it was a spirited discussion th took place within the Consumer Insight Group last fall abo how to use the sacred store environment to promote the mov *Akeelah and the Bee*. Until then the chain had never sullied cafés with movie posters or TV monitors.

The answer was to make the cafés a sort of extension of t film, which is about an inner-city African American girl w competes in a national spelling bee. So last April vocabul words from the contests in the film went on Starbucks c sleeves and on café walls, challenging customers' vocabulari It wasn't an overly obvious promotion. Rather than use tra tional methods, says Senior Vice-President for Marketing A Saunders, new projects like this are launched "based mostly our intuition and out of our brand culture.... We know whe feels right." Starbucks plans to co-produce at least two m movies next year.

Missteps have been helpful in understanding how to grow and how not to. *Joe* magazine, in 1999, was one. Magazines a smaller niche than newspapers and a highly personal cho for consumers. After six months, *Joe* was tossed. Last yea "drinking chocolate," called Chantico, served in a dainty s ounce cup, didn't work, either. It was too pricey at almost $3 too small a cup, and had too many calories (390). Gone.

Perhaps Starbucks' riskiest ventures are its music b which let customers compile songs on CDs or in MP3 fold from a song library. The bars change the atmosphere of cafés and have been criticized in the media and on blogs as unnecessary diversion. Saunders counters that customer sa faction is high, and more music bars are likely next year. S knows the plan is ambitious. "But if you know where y brand lines really are, you can push them."

–With Ben Elgin in San Mateo, Ca
Michael Arndt and Roger Crockett in Chica
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Jennifer Elias and Julie Tucker, Founders, SmartsCo

On a wintry night last year, SmartsCo, a publisher of party games, received a frantic call. A retailer needed stock overnight for a holiday event. So Jen and Julie packed their cars and hand-delivered it. "Likewise," says Jen, "when we sorely needed better cash flow, American Express cared enough to make sure we got it."

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Burt's Bees: Up from Craft Fairs

RAND EXPANSION ISN'T JUST for big business. Two decades go the founders of Burt's Bees were peddling their andmade beeswax candles and lip balms at craft fairs in he Northeast. Now the Durham (N.C.) company's eco-riendly personal-care products, some of which still

ort the bearded visage of Maine eekeeper and retired co-founder urt Shavitz, can be found in 22,000 ores, including recent additions Valgreens and CVS. Sales at the com-any, which was acquired by private quity group AEA Investors in 2004, e expected to rise 25% in 2006, to 250 million. Writer Andrew Park oke with Chief Executive John Re-ogle, 40, who joined Burt's from nilever in January, about managing e explosive growth of this offbeat rand.

Vhat drives decisions out brand expansion Burt's Bees?

Ve receive over a thou-nd phone calls and e-ails a week from con-mers. It's through at dialogue that we now where to take our rand. For example, nsumers tell us they solutely adore prod-cts in our hand- and ot-care line. And they y, "Can you help me y giving me a product e that that's good for l over my body?" hat's what really led to r recent launches of a full range of dy lotions.

Vhere do you want to take the brand in e future?

Ve're trying to meet consumer needs om head to toe. We're going to be oving into a men's range and a fuller e of personal cleansing products, to ampoos and conditioners. We just unched a body wash, and we'll unch more products next year. We'll e offering hand soaps and washes rly in the new year.

REPLOGLE Going wide

Any plans for the baby-care market, which is hot right now?

We're just about to introduce a head-to-toe baby wash. Mothers really understand the need for natural care. A lot of our consumers actually [discovered the brand] with their child.

Any products you'll stay away from?

Household care. There's a lot of damage to our planet [from synthetic] things that go down the drain, and our philosophy has always been to be gentle. Frankly we've decided not to move into it at this time.

Have any new categories been disappointments?

Color cosmetics such as eye shadows or blushing creams. Those have not been strong sellers for us.

What's the end game for Burt's Bees?

We don't really see a limit to what we can do. Health and wellness [are part of] a megatrend, and so is the greening of America. All you have to do is listen to major retailers talk about sustainability, and you see the confluence of consumer trends and retailer trends. We're right at the heart of that.

Do you risk alienating your core consumers as you move into mainstream stores?

[Our consumer] wants access to her favorite products at all of her favorite retailers. The authenticity of the brand shines through regardless of whether we're in 10,000 or 20,000 or even 30,000 stores.

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The 100 Top Brands

Here's how we calculate the power in a name

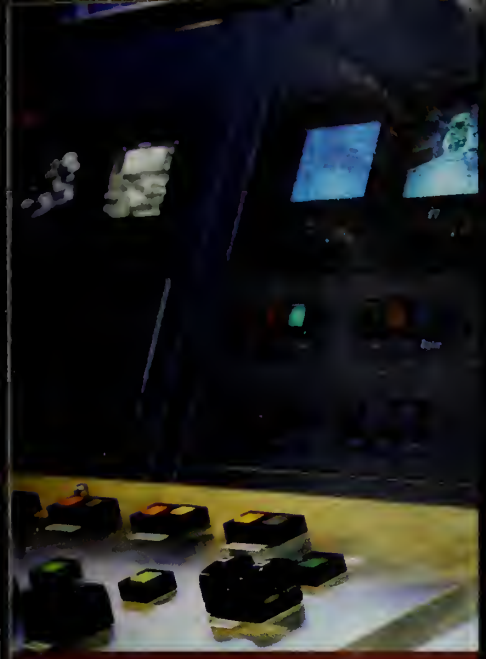
INTERBRAND TAKES lots of ingredients into account when ranking the world's most valuable brands. To even qualify for the list, each brand must derive about a third of its earnings outside its home country, be recognizable outside of its base of customers, and have publicly available marketing and financial data. One or more of those criteria eliminate such heavyweights as Visa, Wal-Mart, Mars, and CNN. Interbrand doesn't rank parent companies, which explains why Procter & Gamble doesn't show up. And airlines are not ranked because it's too hard to separate their brands' impact on sales from factors such as routes and schedules.

***BUSINESSWEEK* CHOSE** Interbrand's methodology because it evaluates brands much the way analysts value other assets: on the basis of how much they're likely to earn in the future. The projected profits are then discounted to a present value, taking into account the likelihood that those earnings will actually materialize.

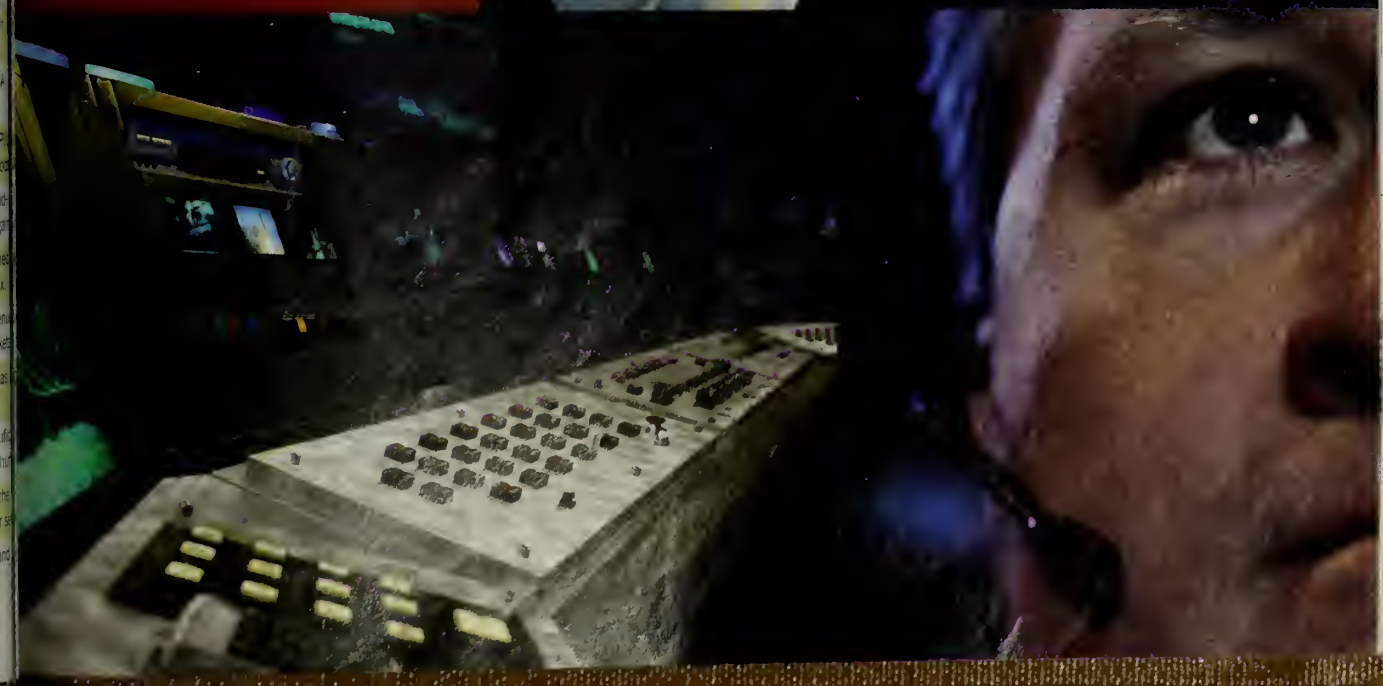
THE FIRST STEP IS figuring out what percentage of a company's revenues can be credited to a brand. (The brand may be almost the entire company, as with McDonald's Corp., or just a portion, as it is for Marlboro.) Based on reports from analysts at J.P. Morgan Chase, Citigroup, and Morgan Stanley, Interbrand projects five years of earnings and sales for the brand. It then deducts operating costs, taxes, and a charge for the capital employed to arrive at th intangible earnings. The company strips out intangibles such as patents and management strength to assess what portion of those earnir can be attributed to the brand.

FINALLY, THE BRAND'S strength is assesse to determine the risk profile of those earnings forecasts. Considerations include market leadership, stability, and global reach—or the ability to cross both geographic and cultural borders. That generates a discount rate, which applied to brand earnings to get a net present value. *BusinessWeek* and Interbrand believe th figure comes closest to representing a brand's true economic worth.

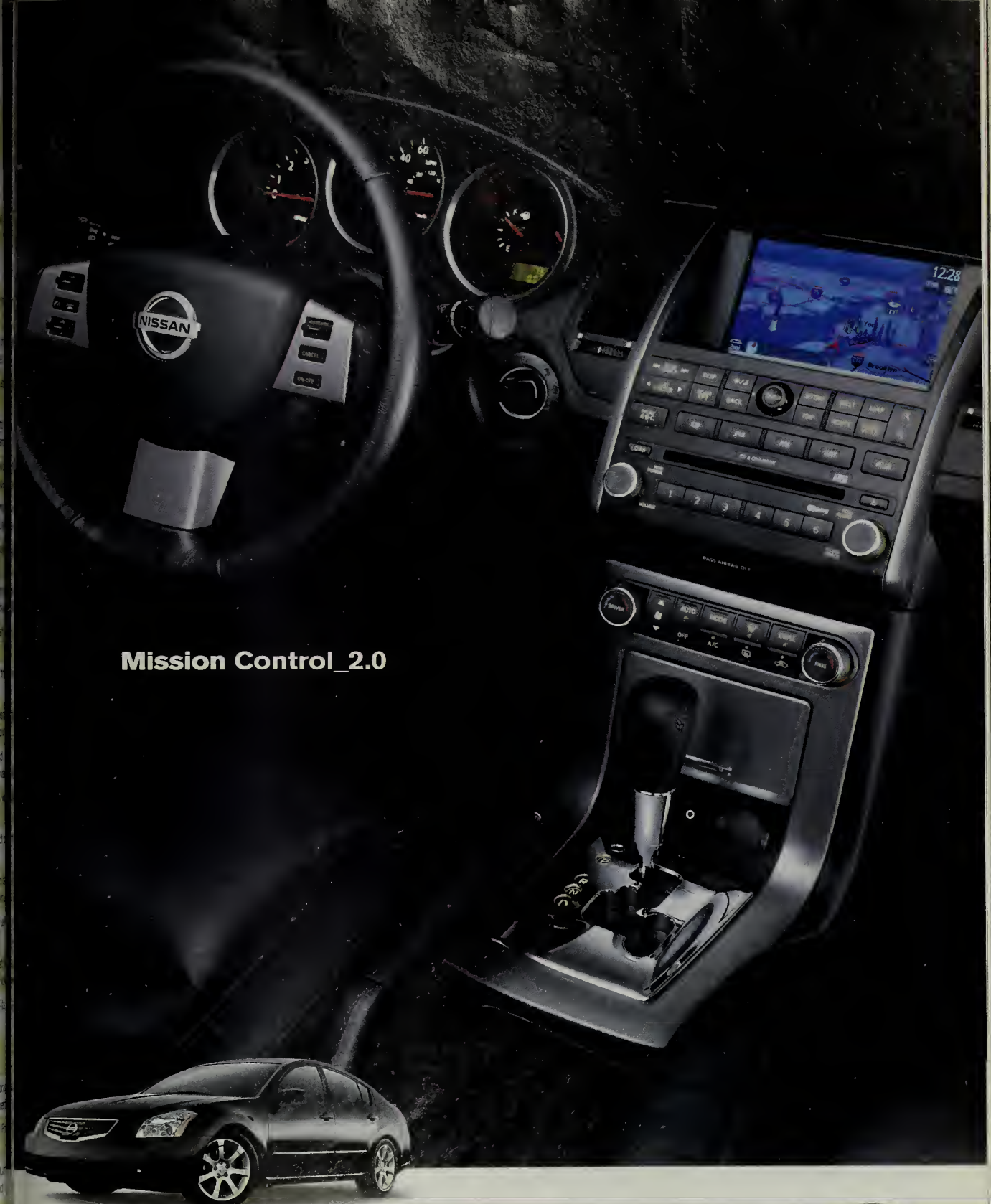
RANK 2006 / 2005			2006 BRAND VALUE $MILLIONS	2005 BRAND VALUE $MILLIONS	PERCENT CHANGE	COUNTRY OF OWNERSHIP	DESCRIPTION
1	1	COCA-COLA	67,000	67,525	–1%	U.S.	Flagging appetite for soda has cut demand for Coke, but the beverage giant ha a raft of new products in the pipeline that could reverse its recent slide.
2	2	MICROSOFT	56,926	59,941	–5%	U.S.	Threats from Google and Apple haven't yet offset the power of its Windows and Office monopolies.
3	3	IBM	56,201	53,376	5%	U.S.	Having off-loaded its low-profit PC business to Lenovo, IBM is marketin on the strategic level to corporate leaders.
4	4	GE	48,907	46,996	4%	U.S.	The brand Edison built has extended its reach from ovens to credit cards, a the "Ecomagination" push is making GE look like a protector of the planet.
5	5	INTEL	32,319	35,588	–9%	U.S.	Profits and market share weren't the only things slammed by rival AMD. Inte brand value tumbled 9%, as it loss business from high-profile customers.
6	6	NOKIA	30,131	26,452	14%	Finland	Fashionable designs and low-cost models for the developing world en- abled the mobile phone maker to regain ground against competitors.
7	9	TOYOTA	27,941	24,837	12%	Japan	Toyota is closing in on GM to become the world's biggest automaker. A slated 10% increase in U.S. sales this year will help even more.
8	7	DISNEY	27,848	26,441	5%	U.S.	New CEO Robert Iger expanded the brand by buying animation hit-maker Pi and beefing up digital distribution of TV shows through the Internet and iPod
9	8	McDONALD'S	27,501	26,014	6%	U.S.	A new healthy-living marketing campaign—and the premium-priced sand- wiches and salads that came with it—have led to a fourth year of sales gai
10	11	MERCEDES-BENZ	21,795	20,006	9%	Germany	The new S-Class sedan and M-Class SUV are helping repair a tarnishe quality reputation. High costs and weak margins will take longer to fix.
11	12	CITI	21,458	19,967	7%	U.S.	Already the biggest U.S. bank, Citigroup's quest to generate more revenu from world markets has it introducing its brand to new emerging market
12	10	MARLBORO	21,350	21,189	1%	U.S.	Marlboro remains firmly in the saddle, particularly outside the U.S., as expands into developing markets.
13	13	HEWLETT-PACKARD	20,458	18,866	8%	U.S.	Under CEO Mark Hurd, HP is skipping glitzy image ads to push specifi products. Improving profits and a 40% stock price increase haven't hu
14	14	AMERICAN EXPRESS	19,641	18,559	6%	U.S.	A preeminent financial-services brand among high-end customers, the company is recasting itself as hip to broaden its appeal to a younger s
15	16	BMW	19,617	17,126	15%	Germany	BMW continues to churn out hot models that buyers love to drive and Japanese automakers can't seem to replicate.



Mission Control



RANK 2006 / 2005			2006 BRAND VALUE $MILLIONS	2005 BRAND VALUE $MILLIONS	PERCENT CHANGE	COUNTRY OF OWNERSHIP	DESCRIPTION
16	15	GILLETTE	19,579	17,534	12%	U.S.	Gillette's new six-bladed Fusion razor met with ridicule when it was introduced. But with Fusion sales soaring, Gillette is still king.
17	18	LOUIS VUITTON	17,606	16,077	10%	France	With a glitzy new flagship on the Champs Elysées, the world's richest luxury brand celebrates yet another year of robust growth.
18	17	CISCO	17,532	16,592	6%	U.S.	Cisco's decision to lead with its Linksys brand for consumers hasn't made the company a household name yet, but it's helping.
19	19	HONDA	17,049	15,788	8%	Japan	As gas prices rise, Honda's gas sippers are helping the Japanese carm er gnaw into the Big Three's market share.
20	20	SAMSUNG	16,169	14,956	8%	S. Korea	Samsung is rolling out hot LCD TVs and ever more powerful memory chi But it is missing in action with low-end handsets, hurting market share.
21	25	MERRILL LYNCH	13,001	12,018	8%	U.S.	Merrill Lynch has made a dramatic transformation from a sleepy, stabl brokerage to a lean and mean investment bank.
22	23	PEPSI	12,690	12,399	2%	U.S.	It tapped a growing obsession with obesity by shifting marketing dollars to D Pepsi. Another boost? Rival Coke's move to copy Pepsi Max with Coke Zero.
23	24	NESCAFE	12,507	12,241	2%	Switzerland	Sales of instant coffee are piping hot in emerging markets, while flavor coffees and new products have boosted appeal in the U.S. and Europe.
24	38	GOOGLE	12,376	8,461	46%	U.S.	Its recent inclusion as a verb in the *Oxford English Dictionary* confirms what competitors feared: Google means search to an army of Web use
25	21	DELL	12,256	13,231	-7%	U.S.	The king of the inexpensive PC is trying to regain trust with a campaig to bolster customer service and technical support.
26	28	SONY	11,695	10,754	9%	Japan	Sony CEO Howard Stringer has fixed the TV biz, but other electronics pr ucts are struggling. He's betting PlayStation 3 can help turn things arour
27	26	BUDWEISER	11,662	11,878	-2%	U.S.	A price war and changing tastes left the No. 1 beer maker with a nasty hangover. The drop in profits for 2005 was its first in a decade.
28	29	HSBC	11,622	10,429	11%	Britain	With retail, private, and investment banking operations in 76 countries, the world's local bank is fast becoming a major force in financial services.
29	27	ORACLE	11,459	10,887	5%	U.S.	Last year, Oracle bought another major software brand, Siebel System This year it will have to sew it together and keep its customers happy.
30	22	FORD	11,056	13,159	-16%	U.S.	The iconic auto brand has declined in every measure. Weak marketing, bad press, shallow product portfolio, and a bottomed-out U.S. stock price hurt valu
31	30	NIKE	10,897	10,114	8%	U.S.	Nike won in both the casual fashion and hard-core athletic markets wi innovative new products, marketing, and partnerships.
32	32	UPS	10,712	9,923	8%	U.S.	China-to-U.S. routes are paying off handsomely, while a big contract t consolidate shipments for Dell is providing a boost back at home.
33	34	JPMORGAN	10,205	9,455	8%	U.S.	Unlike other big banks selling money management units, JPMorgan is building a brand in the business, as merger integration efforts continu
34	36	SAP	10,007	9,006	11%	Germany	New software aimed at smaller businesses helped SAP extend its cus- tomer base beyond blue chips.
35	35	CANON	9,968	9,044	10%	Japan	Digital cameras and copiers helped Canon become one of Japan's most p itable companies. New boss Tsuneji Uchida brings technological knowhov
36	33	MORGAN STANLEY	9,762	9,777	0%	U.S.	CEO John J. Mack is overhauling the firm, and its brand, to restore its former reputation as the top investment bank.
37	37	GOLDMAN SACHS	9,640	8,495	13%	U.S.	Goldman's repeated blockbuster trading results have made it Wall Street's most profitable money machine.
38	31	PFIZER	9,591	9,981	-4%	U.S.	Sold its over-the-counter unit to focus on developing new prescription drug a smart move as powerhouse brands such as Lipitor face generic competit
39	41	APPLE	9,130	7,985	14%	U.S.	Apple continues to be the style master with its expanded family of iPo and Mac PCs. Its latest hit: the MacBook line of laptops.
40	39	KELLOGG'S	8,776	8,306	6%	U.S.	The cereal maker is striking an effective balance between healthy product like Special K and sugary treats like Pop Tarts to attract both moms and k
41	42	IKEA	8,763	7,817	12%	Sweden	Its affordable Scandinavian designs have helped the Swedish retailer come a household name from San Diego to Shanghai.
42	44	UBS	8,734	7,565	15%	Switzerland	Melding private banking and investment banking continues to pay off time, especially in Europe and Asia.
43	43	NOVARTIS	7,880	7,746	2%	Switzerland	The Swiss pharmaceutical giant is expanding across everything from prescription drugs to generic medicines, vaccines, and diagnostics.
44	45	SIEMENS	7,828	7,507	4%	Germany	New CEO Klaus Kleinfeld has disposed of poor-performing telecom ur allowing Siemens to focus on businesses such as medical equipment.



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RANK 2006 / 2005			2006 BRAND VALUE $MILLIONS	2005 BRAND VALUE $MILLIONS	PERCENT CHANGE	COUNTRY OF OWNERSHIP	DESCRIPTION
45	46	HARLEY-DAVIDSON	7,739	7,346	5%	U.S.	Still the king of the hogs. Growing sales to women augment the loyal customer base of baby boomers and hard-core bikers.
46	49	GUCCI	7,158	6,619	8%	Italy	Designer Frida Giannini still can't match predecessor Tom Ford's star power. But sales of apparel and leather accessories are growing nicely
47	55	EBAY	6,755	5,701	18%	U.S.	Investors may not like increasing competition from the likes of Google but TV ads keep boosting the online marketplace's brand appeal.
48	53	PHILIPS	6,730	5,901	14%	Netherlands	Buoyed by the success of its medical equipment and high-tech consum gadgets, Philip's focus on cutting-edge, easy-to-use products is paying
49	51	ACCENTURE	6,728	6,142	10%	Bermuda	Bundling consulting and outsourcing gigs is helping Accenture stay fier Last year, sales grew by more than twice the rate of other tech-services fir
50	48	MTV	6,627	6,647	0%	U.S.	Now 25, MTV is pushing into broadband with the MTV Overdrive site, whe faces competition with MySpace and YouTube for teens' attention.
51	50	NINTENDO	6,559	6,470	1%	Japan	Nintendo is No.1 in portable video-game consoles, but the unconventic new Wii console machine due out this autumn could be a harder sell.
52	40	GAP	6,416	8,195	-22%	U.S.	Still searching for its fashion identity, the clothier's sales are fraying as struggles to dress the twentysomething crowd for both work and weeke
53	52	L'OREAL	6,392	6,005	6%	France	This French cosmetics maker's finances are looking prettier, thanks to rebound in sluggish European sales.
54	47	HEINZ	6,223	6,932	-10%	U.S.	Slimming its portfolio and adding products like Lea & Perrins hasn't be enough for Heinz to compete with retailers' in-house brands.
55	58	YAHOO!	6,056	5,256	15%	U.S.	The company risks looking like an also-ran next to Google, but Yahoo mining for hits in new areas like social networking and digital content.
56	56	VOLKSWAGEN	6,032	5,617	7%	Germany	Maybe the most resilient brand in its industry. VW is solving its quality and financial issues, and customers are coming back.
57	54	XEROX	5,918	5,705	4%	U.S.	Xerox' stable of color copiers is bringing in a good supply of cash, but has yet to make its mark in the digital world.
58	60	COLGATE	5,633	5,186	9%	U.S.	Well into a four-year restructuring, Colgate now has something to smile at with new launches such as Luminous toothpaste finding strong demand
59	57	WRIGLEY'S	5,449	5,543	-2%	U.S.	With new players chewing away at market share, Wrigley's has been expa ing into areas like candy and mints with brand extensions and acquisition
60	61	KFC	5,350	5,112	5%	U.S.	Avian flu fears in early 2006 slowed KFC's growth in China, the chain's hottest market, but KFC sales are rebounding.
61	65	CHANEL	5,156	4,778	8%	France	Fresh-faced Keira Knightly is replacing bad-girl Kate Moss as the face Coco Mademoiselle perfume.
62	59	AVON	5,040	5,213	-3%	U.S.	Avon ladies have been struggling. Poor results in many markets, including Eastern Europe, forced CEO Andrea Jung to launch a restructuring this ye
63	66	NESTLE	4,932	4,744	4%	Switzerland	Best known for chocolate, Nestlé posts stronger growth from other products, such as Nestlé Aquarel bottled water.
64	64	KLEENEX	4,842	4,922	-2%	U.S.	A mature brand that's working to fend off commodity status. Emotion advertising is helping buoy its image against private labels.
65	68	AMAZON.COM	4,707	4,248	11%	U.S.	Heavy spending on technology for digital media initiatives has depres the stock, but free shipping and reliability keep customers happy.
66	63	PIZZA HUT	4,694	4,963	-5%	U.S.	Pizza Hut sales have been drooping as Americans turn increasingly to sandwiches and Mexican fare.
67	67	DANONE	4,638	4,513	3%	France	A growing global appetite for yogurt keeps the French food and bever giant in good health.
68	70	CATERPILLAR	4,580	4,085	12%	U.S.	Demand for Caterpillar's rugged machines and engines has never bee stronger. Cat is on track to top $40 billion in sales this year.
69	73	MOTOROLA	4,569	3,877	18%	U.S.	New products like the RAZR and SLVR have been a hit, and a hip marketing campaign behind them is adding luster to the Moto brand.
70	62	KODAK	4,406	4,979	-12%	U.S.	Kodak has defied skeptics by becoming a major player in digital photography and printing, but profits remain disappointing.
71	71	ADIDAS	4,290	4,033	6%	Germany	The World Cup was a bonanza for the sports-apparel maker. Securing the sp sorship helped keep archrival Nike at bay before the world's largest audie
72	72	ROLEX	4,237	3,906	8%	Switzerland	Rolex remains the ultimate luxury brand worldwide, and with strong s in China, its appeal continues to spread.
73	77	ZARA	4,235	3,730	14%	Spain	With its focus on high fashion at low prices, Europe's biggest clothing retailer is so popular that it's opening more than a store a day in 200

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RANK 2006 / 2005			2006 BRAND VALUE $MILLIONS	2005 BRAND VALUE $MILLIONS	PERCENT CHANGE	COUNTRY OF OWNERSHIP	DESCRIPTION
74	79	AUDI	4,165	3,686	13%	Germany	Eye-catching design, hot technology, and a new American-size SUV called th Q7 are transforming Audi into a serious global rival to BMW and Mercedes.
75	84	HYUNDAI	4,078	3,480	17%	S. Korea	Fast shedding its image as a cheap automaker. In the latest J.D. Power qua ty survey of new car owners, Hyundai was No. 3, behind Porsche and Lexus
76	75	BP	4,010	3,802	5%	Britain	Not even an Alaskan oil spill or an explosion at a Texas refinery has put dent in BP's strong performance.
77	78	PANASONIC	3,977	3,714	7%	Japan	It's a force in flat-screen TVs, digital cameras, and chips but hasn't turn first-rate technology into better brand equity.
78	74	REUTERS	3,961	3,866	2%	Britain	The global news and financial information giant is moving into derivati trading with a collaboration with the Chicago Mercantile Exchange.
79	69	KRAFT	3,943	4,238	–7%	U.S.	Fierce competition and rising commodity costs have dogged the U.S.'s larg foodmaker. Kraft's new CEO needs innovative new products to revive sales.
80	76	PORSCHE	3,927	3,777	4%	Germany	CEO Wendelin Wiedeking extends his 10-year winning streak with perfec timing and precision execution on the Cayman.
81	82	HERMES	3,854	3,540	9%	France	Best known for leather accessories and silk scarves, Hermes is riding high on the success of a new perfume, Un Jardin Sur le Nil.
82	81	TIFFANY & CO.	3,819	3,618	6%	U.S.	With sales sparkling in many markets, the retailer's focus on service and design has helped it battle a new set of discount online competitors.
83	86	HENNESSY	3,576	3,201	12%	France	As the brand gets a marketing assist from adoring hip hop artists in the U.S., the French cognac maker is pushing for growth in China and India
84	80	DURACELL	3,576	3,679	–3%	U.S.	Duracell has been gaining share in the market for premium replaceable batteries, but will rechargeable batteries threaten the long-term outlook
85	87	ING	3,474	3,177	9%	Netherlands	ING continues its global expansion moving beyond its banking and insurance roots into the asset management business.
86	89	CARTIER	3,360	3,050	10%	France	The popularity of Pasha timepieces and Caresse d'Orchidées jewelry is putting a sparkle in Cartier sales.
87	92	MOET & CHANDON	3,257	2,991	9%	France	Global sales of Champagne are up 54% since 1990, and Moet's "Be Fabulous" campaign has cemented the brand in the center of the mark
88	91	JOHNSON & JOHNSON	3,193	3,040	5%	U.S.	There's more than one way to grow, as J&J showed by paying $16.6 billi for Pfizer's consumer-products unit.
89	90	SHELL	3,173	3,048	4%	Britain	Despite pension problems and pipeline explosions, soaring oil prices fueled Shell to record 2005 profits of $23 billion.
90	85	NISSAN	3,108	3,203	–3%	Japan	Starved for new models, Nissan's sales have slipped. New launches, including a remodeled Altima, will be a timely boost for CEO Carlos Gho
91	99	STARBUCKS	3,099	2,576	20%	U.S.	Starbucks brings in customers with lifestyle marketing, pushing music, books, and lunch food to get them to stick around.
92	NEW	LEXUS	3,070	New	New	Japan	Toyota's relatively young Lexus premium brand is No. 1 in the U.S., but just getting started in Asia and Europe.
93	88	SMIRNOFF	3,032	3,097	–2%	Britain	The vodka market continues to attract new entrants; Smirnoff needs to b ter define a sophisticated identity to stay ahead of the pack.
94	97	LG	3,010	2,645	14%	S. Korea	This Korean electronics maker is emulating its crosstown rival, Samsur boasting stylish handsets and digital TVs.
95	94	BULGARI	2,875	2,715	6%	Italy	Italian jeweler Bulgari is powering growth with the help of a super-luxu hotel chain and customers like Madonna.
96	93	PRADA	2,874	2,760	4%	Italy	Anti-Establishment Italian fashionista Miuccia Prada keeps testing the frontiers of taste: Edgy clothing design, edgier store architecture.
97	95	ARMANI	2,783	2,677	4%	Italy	Fashion icon Giorgio Armani proves his appeal extends beyond the closet as he expands into everything from minimalist sofas to five-star resorts.
98	NEW	BURBERRY	2,783	New	New	Britain	Moving beyond its signature plaid, Burberry is beefing up its accessories line and expanding its retail profile in the U.S.
99	98	NIVEA	2,692	2,576	4%	Germany	In a bid to shed its austere image, the company is expanding into new products such as skin-firming lotion and men's eye cream.
100	96	LEVI'S	2,689	2,655	1%	U.S.	This iconic brand is fighting to stand out among such high-end names a Earnest Sewn and, at the mass level, discounters' private-label jeans.

The brand valuations draw upon publicly available information, which has not been independently investigated by Interbrand. Valuations do not represent a guarantee of future performance of the bra or companies.

Data: Interbrand, JPMorgan Chase & Co., Citigroup, Morgan Stanley, *BusinessW*

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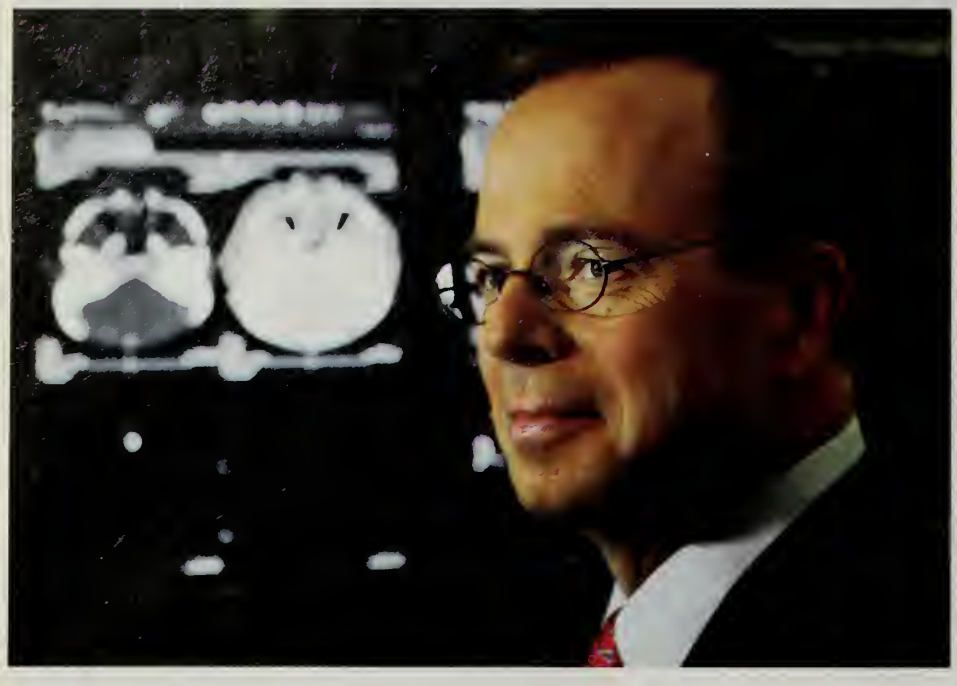


McKesson's Booster Shot

The problem: huge sales, tiny profits. High-margin tech products could help

BY ARLENE WEINTRAUB

McKESSON CORP. holds the unenviable distinction of being one of the world's biggest yet least profitable companies. The San Francisco drug distributor has $88 billion in annual sales, making it the 16th-largest company in the U.S. But during the year that ended Mar. 31, McKesson squeezed out just $751 million of net profit. Ever since it started delivering drugs by horse-drawn wagon in the 1830s, it has tried to boost efficiency in an inherently low-profit business. The result: 3% gross margins in drug distribution.

No surprise, then, that Chief Executive John H. Hammergren is looking for ways to build a healthier bottom line. One strategy has been to expand into the high-margin business of selling technology to doctors, hospitals, and insurance companies. McKesson's move started inauspiciously: In 1999, the company acquired software maker HBO & Co. for $12 billion, and then discovered that its previous management team had artificially inflated revenues. Last year, McKesson paid $960 million to settle a securities class action that was filed as its stock plunged. With scandal in its rearview mirror and with improving cost trends in distribution, McKesson's stock has returned 14.8% in the past year, compared with 2.6% for the S&P 500 Health Care Index. The company reached No. 48 on the *BusinessWeek* 50 list of the top-performing big companies.

The Best Performers

Some of McKesson's new tech offerings aim to transform the way patients interact with doctors. Instead of waiting on hold, they can log on to the Web to zap questions to their physicians and even have virtual visits with them. Rather than

HAMMERGREN Snapping up startups to lift McKesson's tech expertise

trying to build techn gy knowhow from ground up, McKes has been snapping innovative start bringing in a v range of expertise. In May it acqu billing software maker HealthCom P ners, and in June it picked up RelayHe which has developed a Web-based o management system for doctors. "W filling out the white space between ou lutions," Hammergren says.

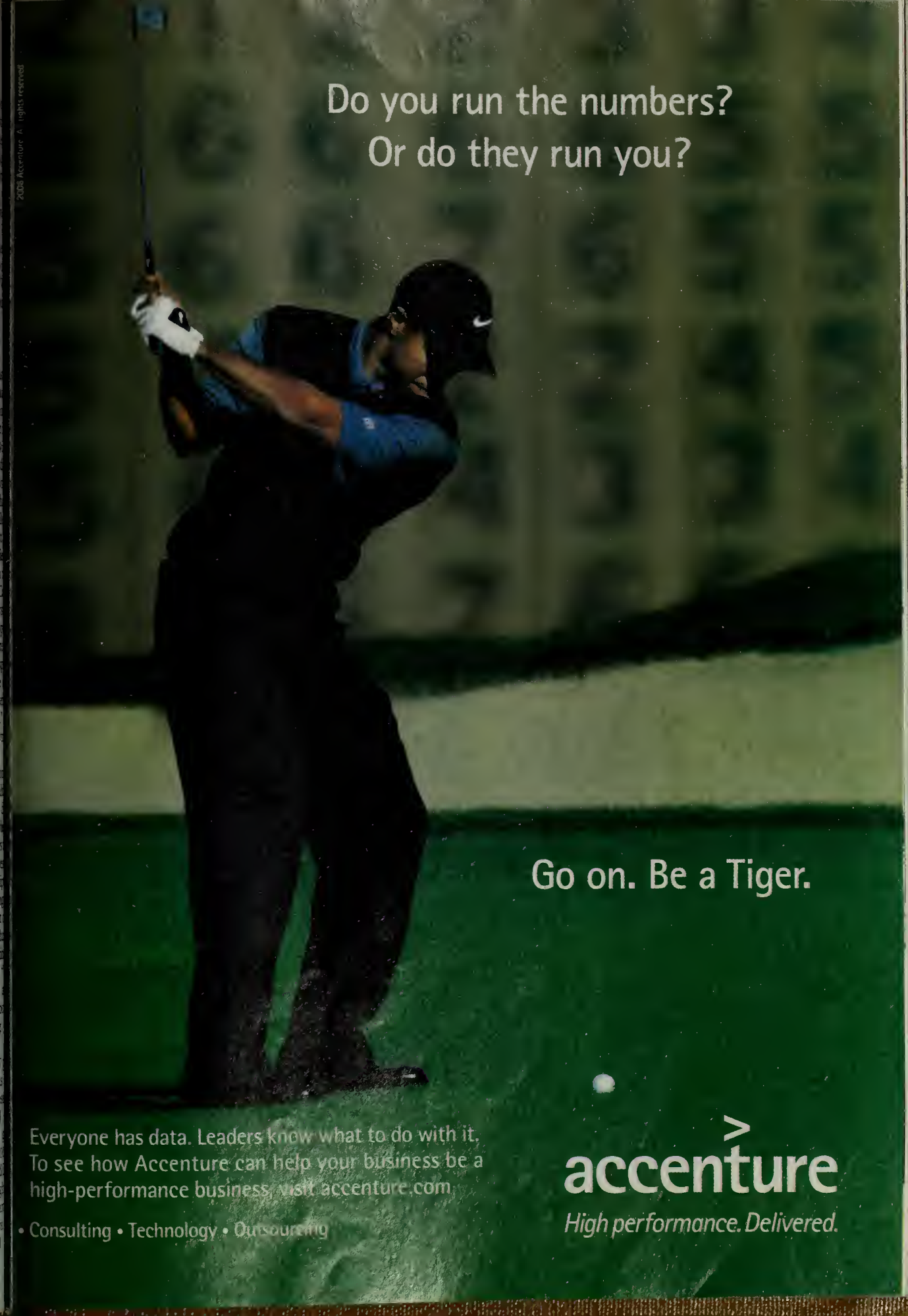
STORMING DOCTORS

THE FINANCIAL REWARDS are fast coming evident. Although the technol unit accounted for just $1.5 billio McKesson's sales in the most recent fi year, its gross profit margin was 46. astronomical compared with drug di bution. Eric W. Coldwell, an analyst Robert W. Baird & Co., estimates tha sales will grow 25% by 2008, while drug distribution side will grow just 1

Health-care IT is a fragmented, fier competitive business, however, with ri ranging from General Electric Co Cerner Corp. scrambling to get syst into doctors' offices and hospi McKesson's ability to automate health-care players—doctors, hospi insurers and patients—could give i edge. "There are not a lot of competi who offer integrated solutions," John W. Ransom, an analyst for Raym James Financial Inc.

Customers say McKesson's solution more nimble than its rivals'. RelayHealth example, is designed to link to many di ent hospital systems regardless of whe they're sold by McKesson. And it offers t savers such as the ability to order pres tions via the Web. "When I call prescript in, I get put on hold, I get angry, I hang says Dr. Richard U. Levine, president o faculty practice organization at Colu University, which has begun outfittin physicians' offices with the software. " Relay it's more efficient, a don't have to worry abo pharmacist misreading handwriting."

While boosting its IT p ence, Hammergren has been selling off McKess least profitable units. Coldwell mates that McKesson's overall g margin will rise from 4.2% in 200 4.4% in 2008. That may not sound l big deal, but it's a step in the righ rection. "McKesson is going thro portfolio cleansing," Coldwell says. exactly what they need to do."



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Big Blue Brainstorm

IBM is putting some 100,000 heads together for an online Innovation Jam

BY JESSI HEMPEL

THE COLLECTIVE WISdom of crowds depends on your crowd, and IBM has one of the sharpest crowds around. CEO Samuel J. Palmisano knows this, and he wants to leverage it. He is pulling people together for the online equivalent of a town meeting. His hope: The opinions of some 100,000 minds will lead to catalytic innovations so powerful they will transform industries, alter human behavior, and lead to new businesses for IBM. He calls the project an Innovation Jam.

Jams are nothing new at IBM. The company used these online brainstorming sessions to mine for new business opportunities in 2001, to exchange ideas about good management in 2002, and to discuss IBM values in 2003. But the current jam is the biggest ever and the first to go open source. IBM is inviting clients, consultants, and employees' family members to tinker with its technologies in pursuit of new ideas. IBM won't own any of the nuggets that emerge during the two 72-hour sessions—they are fair game for anyone who logs on.

Palmisano says the company will put up to $100 million behind the strongest ideas. He told employees it is the first time "a technology company takes its most valued secrets, opens them up to the world and says, O.K., world, you tell us" what to do with them.

Grand-scale innovation breakthroughs have never been more important for IBM. The company's current reputation for constant incremental innovation hasn't inspired investors. IBM's stock price has remained fairly flat for the past three years, closing at 75.99 on July 24. Recent earnings gains have come through cost-cutting, not the growth spurred by new business. As A competitors like InfoSys Technologies eat into its core business, IBM nee bring to market new products and ser

To prepare those invited to ticipate, the company bui interactive Web site tha cludes sound clips, vi guided tours, and v snippets with backgr information. The went live just past 10 on Monday, July 24. moderators were assi to four topics: transp tion, health, the environment finance and commerce. The site tially slowed under the collective w of thousands of simultaneous log-in then IBM employees began throwin conversation starters. In one riff, p debated using RFID-tagged bracele improve the traveler's experience a airport. A strand focused on early w ing systems for health pandemics. I other, folks weighed in on going t movies, suggesting sensorial experie such as seat movements and misting ter to accompany their favorite films. prompted someone to ask: "Will a ma that sprays water do damage t hearing aids?"

Of course, there is danger in I open-source approach to sharing i Sixty-seven clients, from Bank of Am to Circuit City to Massachusetts Inst of Technology, will have first-row sea the company hashes out its strategie the future. It's possible that compe could lurk in virtual chat rooms, liste in on new ideas. "Without risk, there innovation," said Ed Bevin, vice-pres of communications for IBM researc one of the jam's chief architects.

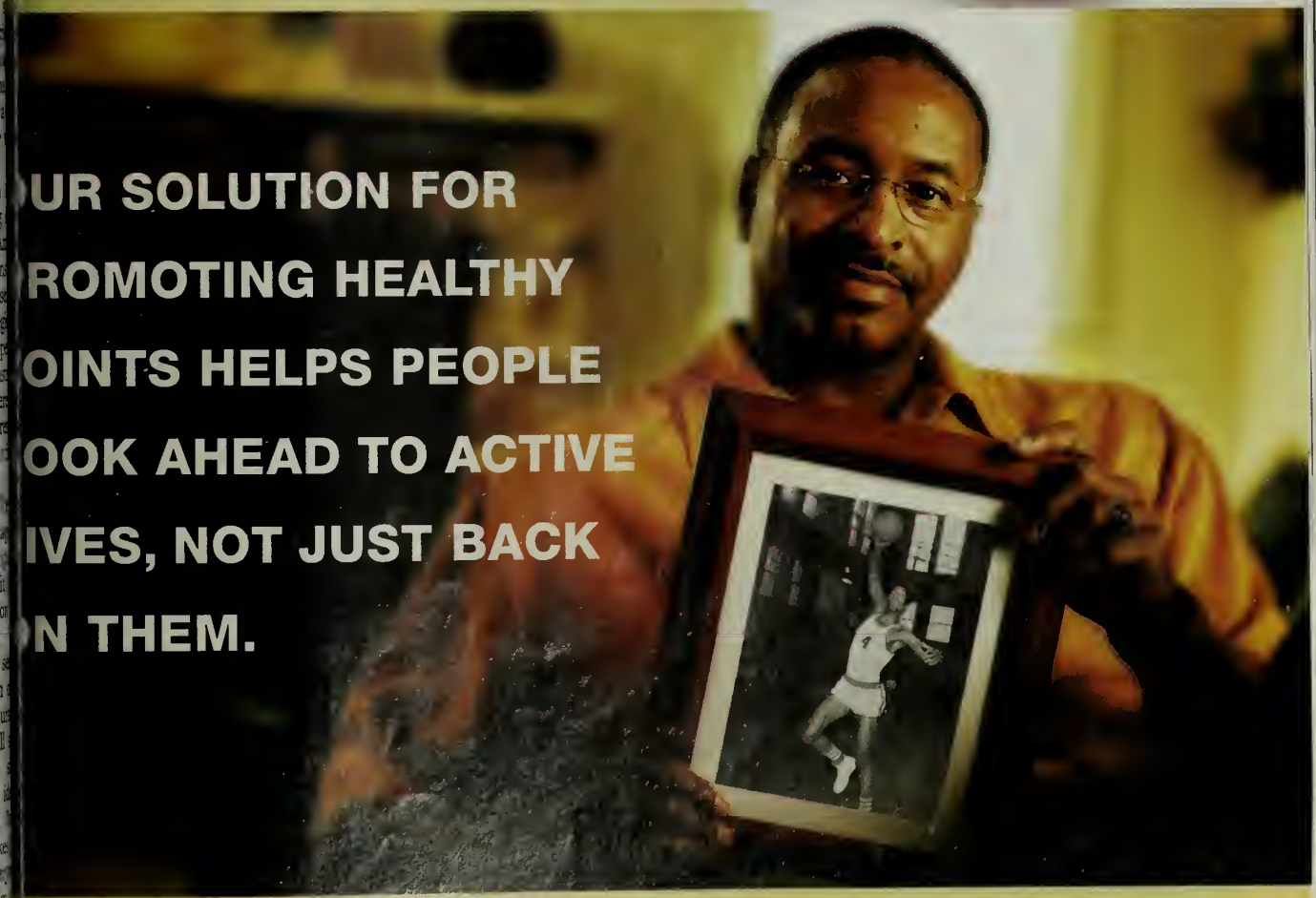
The event could have payoffs be new ideas. It will build IBM's image forward-thinking global compe showing its Indian competitors it i the one to beat in the $650 billion services industry.

As with any brainstorming ses only a small fraction o ideas will be worth purs Teams of IBMers will s the next month si through the posts to ide the most promising. D phase two, which takes September 12-15, everyo invited back to the jam s refine and rate the best based on their business v Stay tuned.

Up to $100 million will go to the best ideas

: active pursuit of life is something we all strive for. To help keep
ir joints healthy, millions have turned to dietary supplements like
ondroitin and glucosamine pills. One nutritional company saw
opportunity in making a drinkable version of these supplements
d turned to Cargill for help. Our scientists created a good-
ting liquid form of chondroitin and glucosamine that made their
ormulated product possible. The result is a supplement for joint
lth that's easy to swallow...providing a new choice for consumers
he marketplace. This is how Cargill works with customers.

ollaborate > create > succeed



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A Year of Beating The Indexes

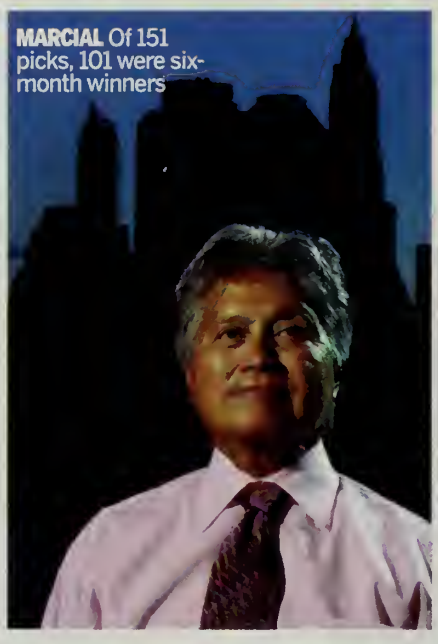
Our Inside Wall Street columnist made some prescient choices in 2005

BY JOSEPH WEBER

PROFESSIONAL MONEY managers are always on the hunt for "alpha." That's finance jargon for superior performance, an ability to beat market indexes on a regular basis. Gene G. Marcial, the *BusinessWeek* veteran who writes our Inside Wall Street column, produced it in abundance last year. As usual, most of his 151 picks made a fast start as readers acted on his information. But many stocks he mentioned kept steaming ahead. On average, they beat five major indexes over one day, and after one, three, and six months—among Marcial's best showings in the nine years we've tracked his performance.

His biggest average gain, 10.2%, was made over six months, when 101 of his picks, or two-thirds, were winners. Over the comparable period, the average six-month gain in the Dow Jones industrials was 2.8% and 4.2% in the Standard & Poor's 500-stock index. Only the Russell 2000 index of small stocks came close, with an average 9.2% six-month gain. Marcial finds the stocks he highlights by talking with money managers, analysts, and investors. He looks for companies that are potential takeover targets, that are undervalued because Wall Street is overlooking important developments, or that may break out because of a product launch or other event. For instance, Marcial featured E*Trade Financial Corp.'s push into banking. The shares climbed 36.9% after six months.

To plot Marcial's performance, we start with the closing price of each stock on Thursday, just before *BusinessWeek* is first available on businessweek.com. Then we track the stock over the following six months. We calculate one-day and one-, three-, and six-month price changes in each case and compute the average performance for each period. Finally, we compare them with the major stock indexes. (For three weeks Marcial was relieved by *BusinessWeek* colleagues David Henry and Mara Der Hovanesian, wh picks are included in the results.)



MARCIAL Of 151 picks, 101 were six-month winners

Marcial's picks aren't widow-and phan stocks to buy and forget. Inves need to keep close tabs on them. For stance, WPT Enterprises Inc., which o ates the World Poker Tour, turned into biggest loser on the list as excitement poker dimmed and a hoped-for take didn't happen. Also, Marcial's only s last year came to grief. In February sources pooh-poohed talk that May Dep ment Stores Co. could be acquired by Federated Department Stores Inc. Bu stead of falling, May's stock rose by r than $8, and Federated did indeed buy

BLUE-CHIP GAINERS

STILL, MARCIAL PRODUCED enc winners to more than offset the dogs ter one day, 120 of his picks were up, medical gear maker Misonix Inc. cli ing 10.8% on buzz about its new So late 500 ultrasound device for trea prostate cancer. After a month, 92 o picks were still gainers, led by data-s age specialist Western Digital Corp 44.1%. Nearly as many, 90, were still u the end of three months, led by oil r ery technology company SulphCo which was up 333% at one stage. Am ca West Airlines Inc. was tops among gainers after six months. Its acquisitio US Airways Group Inc. helped boos stock by 129.9%.

Despite a generally lackluster yea blue chips, several of Marcial's big-c pany picks produced market-bea gains. Consider Marathon Oil Corp. ing the wave of interest in energy st it turned in a 52% rise after six mo moving from about 36 to 55.

Although he handily beat all the in es against which we measure him, cial undoubtedly was helped by the erally positive tone of stock markets. the market's gyrations this year, it m harder to produce all that alpha agai

–With Sarah B. Davis, Mi Mandel, and David Purcell in New

An Alpha Showing

Inside Wall Street featured 151 stock picks in 50 issues of *BusinessWeek* last year. For each issue, the returns for the column and the main market benchmarks were calculated for four periods. The returns were averaged over all 50 issues. Here are the results:

	1 DAY	1 MO.	3 MOS.	6 M
Inside Wall Street	2.0%	2.6%	7.3%	10.
Standard & Poor's 500	0.1	0.6	1.8	4.
Dow Jones Industrials	0.0	0.3	0.7	2.
NASDAQ Composite	0.0	0.8	2.7	6.
Wilshire 5000	0.1	0.8	2.4	5.
Russell 2000	0.1	1.0	3.7	9.

Data: *BusinessWeek*, Global Insight, Standard & Poor's

nside Wall Street **Scorecard**

se are the 151 stocks featured in the column last year. For each, give the last closing price before Inside Wall Street became lic, usually on a Thursday, at businessweek.com. Then we npute the one-day, one-month, three-month, and six-month percentage returns. If these periods end on a weekend, we use the previous Friday's closing price. When a company is taken over within six months, we calculate prices up to the merger's effective date. The Thursday close is 11 days before the issue date.

PANY NAME / SYMBOL	CLOSING PRICE THURSDAY	PERCENT CHANGE 1 DAY	1 MO.	3 MO.	6 MO.	ISSUE DATE
rr Pharmaceuticals BRL	45.54	0.0	2.2	6.6	7.0	1/10
iliated Managers AMG	67.61	0.2	-7.5	-9.9	1.1	1/10
gnos COGN	44.47	-0.9	-8.3	-5.1	-23.2	1/10
rathon Oil MRO	36.28	1.5	11.6	33.4	52.0	1/17
vado Group MOV	17.96	1.6	0.0	1.2	6.6	1/17
rnell CRN	15.64	-2.4	-1.6	-18.8	-10.9	1/17
nCorp GY	17.65	2.8	2.7	14.4	12.5	1/24
ectrum Pharma. SPPI	6.39	0.2	-3.8	-3.4	-31.1	1/24
ndag BDG	47.26	2.0	-0.2	-1.5	0.2	1/24
lumberger [1] SLB	32.26	0.2	14.0	-26.1	21.6	1/31
J Snack Foods [2] JJSF	21.61	9.1	6.7	10.8	24.3	1/31
ltron ARB	37.51	0.1	10.3	9.4	-27.8	1/31
site BSTE	55.92	2.5	5.0	3.3	3.4	2/7
owhead Research ARWR	3.90	-3.3	7.7	-28.2	-22.6	2/7
ger KR	17.29	-0.3	2.0	-8.6	14.7	2/7
as Instruments TXN	23.13	7.2	14.9	8.9	40.5	2/14
oktrout [3] BRKT	11.81	4.1	4.5	-17.7	-15.7	2/14
AX IMAX	10.32	9.5	6.6	-14.7	0.7	2/14
eing BA	53.86	0.5	7.6	13.3	22.5	2/21
bre Holdings TSG	20.74	2.0	4.3	-4.1	-9.0	2/21
lex IRIX	5.04	7.7	9.3	15.9	45.2	2/21
y Dept. Stores [4] MAY	31.52	-12.2	-35.4	-40.0	-56.8	2/28
n Office Solutions IKN	10.65	0.7	-3.7	-10.7	-6.2	2/28
imas [5] PUMP	18.62	8.1	10.2	-4.9	-3.1	2/28
adarko Petroleum [6] APC	36.00	8.0	2.9	2.4	22.3	3/7
C Enterprises AFCE	25.77	1.8	-2.2	-1.2	-45.3	3/7
crovision MVIS	5.38	3.2	10.6	24.0	0.4	3/7
ere DE	70.54	2.6	-6.1	-8.5	-7.8	3/14
pax Laboratories IPXL	17.20	5.4	-6.1	-4.6	-34.9	3/14
nosite SONO	27.37	4.5	-8.8	15.6	30.6	3/14
r 1 Imports PIR	18.78	2.5	-11.3	-19.1	-33.1	3/21
ne Warner TWX	17.75	-1.4	1.2	-6.1	3.3	3/21
althtronics HTRN	10.73	-2.1	11.5	25.5	-0.3	3/21
IR AMR	8.66	1.7	18.9	45.5	37.1	3/28
hkosh Truck [7] OSK	39.99	1.7	-5.0	-1.7	4.3	3/28
nomyx SNMX	12.03	3.1	-4.1	32.1	53.0	3/28
nry Schein HSIC	36.00	1.0	2.8	15.2	19.3	4/4
ritrans TUG	18.09	2.9	-1.9	43.5	75.7	4/4
Trade Financial ET	11.98	1.6	-7.9	13.8	36.9	4/4
tLife MET	39.10	-0.6	-0.5	16.3	27.4	4/11
acia Research ACTG	5.65	0.9	7.8	-17.2	8.7	4/11
ot KNOT	7.20	7.2	3.1	-3.5	54.0	4/11
tsie Roll TR	28.93	8.3	3.1	-0.8	4.1	4/18
rrier Therapeutics BTRX	16.29	6.2	8.1	-51.2	-51.0	4/18
ral Financial DRL	19.16	3.4	-22.2	-13.3	-35.8	4/18
ymetrix AFFX	44.06	1.2	7.9	27.0	0.7	4/25
rtas CTAS	40.02	-0.5	-0.4	-0.5	-2.0	4/25
ar Channel Comm. CCU	32.39	-2.1	-11.5	-4.6	-6.6	4/25
co Software TIBX	7.05	1.0	-4.0	3.5	7.7	5/2
ta Funding ASFI	20.90	4.8	26.8	26.9	33.3	5/2
Bioenvision BIVN	6.02	6.0	8.3	29.9	4.2	5/2
Dow Jones DJ	32.20	3.9	12.1	16.8	6.8	5/9
Sun Microsystems SUNW	3.44	5.2	12.5	11.9	12.8	5/9
Starbucks [8] SBUX	24.28	2.0	14.6	8.5	14.5	5/9
Cameron Intl. [9] CAM	28.78	0.5	4.3	24.5	28.3	5/16
American Greetings AM	23.63	1.6	10.8	6.5	8.6	5/16
Varian Semiconductor [10] VSEA	25.08	1.0	5.1	8.7	1.2	5/16
New Century Financial NEW	44.77	-2.4	15.7	-5.4	-20.5	5/23
Industrial Distribution IDGR	8.19	2.3	9.9	13.1	-7.6	5/23
XM Satellite Radio XMSR	28.24	0.1	10.3	19.1	0.9	5/23
North Fork Bancorp NFB	28.08	-0.2	0.9	-2.2	-4.2	5/30
Exelon EXC	46.57	0.6	4.5	10.9	10.4	5/30
Rent-Way RWY	8.94	0.1	8.8	-12.9	-31.5	5/30
News Corp. NWS	16.66	1.5	6.0	3.2	-5.2	6/6
Bed Bath & Beyond BBBY	39.72	1.8	3.8	3.9	8.7	6/6
Snap-on SNA	33.98	1.3	0.8	4.2	11.0	6/6
Peet's Coffee & Tea PEET	29.82	-0.1	14.0	1.1	4.6	6/13
America West [11] AWA	6.15	4.9	-2.6	9.8	129.9	6/13
American Science & Eng. ASEI	37.08	4.5	18.8	72.6	85.5	6/13
Aztar AZR	32.05	3.1	9.2	6.0	-3.3	6/20
PriceSmart PSMT	7.41	5.3	14.2	12.6	9.2	6/20
Perficient PRFT	7.19	3.6	1.3	4.9	32.8	6/20
FedEx FDX	86.71	0.7	-4.2	-7.5	15.2	6/27
Alaska Communications ALSK	9.77	0.3	0.6	13.7	10.1	6/27
Casual Male Retail CMRG	7.14	6.0	6.4	-2.0	-15.1	6/27
Energy Conversion ENER	20.69	7.2	22.0	95.7	70.4	7/4
Access Integrated Tech. [12] AIXD	7.63	4.6	37.0	41.3	38.1	7/4
Jones Soda JSDA	6.72	2.1	-12.8	-17.7	-22.3	7/4
MBNA [13] KRB	26.16	-1.5	-3.8	-5.8	3.8	7/11
Capital Southwest CSWC	89.67	2.6	0.3	-5.0	0.9	7/11
Progressive Gaming PGIC	14.73	0.9	-5.0	-9.8	-33.0	7/11
W.R. Berkley [14] BER	23.90	0.0	2.9	6.6	39.4	7/18
Mac-Gray TUC	9.54	4.3	17.9	38.8	21.5	7/18
Polycom PLCM	14.25	3.9	13.1	13.3	16.1	7/18
ING Group ING	29.02	0.3	5.1	-0.6	23.1	7/25
Merck MRK	31.91	0.0	-2.9	-16.2	4.5	7/25
Spectrum Pharma. SPPI	4.39	4.8	5.7	13.0	5.2	7/25
AIG AIG	60.55	0.3	1.1	3.9	10.2	8/1
WPT Enterprises WPTE	21.95	2.1	-34.8	-70.4	-71.4	8/1
Intrado [15] TRDO	15.52	4.6	-3.4	19.1	47.7	8/1
Symbol Technologies SBL	11.69	-0.4	-25.9	-30.5	5.7	8/8
TurboChef Technologies OVEN	16.86	2.8	-1.1	-19.3	-15.9	8/8
Stratagene STGN	8.80	7.0	-0.3	5.5	19.3	8/8
Brink's BCO	38.67	-2.0	4.8	9.9	38.4	8/15
Misonix MSON	6.50	10.8	20.2	-3.5	-11.5	8/15
Charles Schwab SCHW	13.55	-2.0	-1.0	11.6	7.7	8/15
Alpha Natural Res. ANR	27.72	1.8	13.1	-18.8	-23.9	8/22
Pier 1 Imports PIR	14.25	1.8	-11.9	-14.1	-21.6	8/22
New River Pharma. [16] NRPH	19.74	2.0	5.3	29.4	55.1	8/22
Alaska Air Group ALK	33.78	0.8	-10.7	4.5	-6.2	9/5

Inside Wall Street Scorecard

COMPANY NAME / SYMBOL	CLOSING PRICE THURSDAY	PERCENT CHANGE 1 DAY	1 MO.	3 MO.	6 MO.	ISSUE DATE
AMR AMR	13.61	0.4	-19.0	25.5	85.4	9/5
Tarragon TARR	20.99	0.0	-15.0	-2.1	-4.9	9/5
Atherogenics AGIX	16.34	6.6	1.2	-3.1	-4.0	9/5
Target TGT	52.78	0.7	-1.6	1.9	3.4	9/12
Kinetic Concepts KCI	56.31	3.0	0.9	-27.0	-33.4	9/12
Illinois Tool Works [17] ITW	42.78	0.1	-3.8	4.7	3.2	9/12
AMN Healthcare AHS	16.52	1.4	-7.6	21.2	23.4	9/19
Chesapeake Energy CHK	32.72	1.9	4.0	-3.9	-8.3	9/19
CVS CVS	29.10	1.3	-12.1	-4.1	3.3	9/19
Hyperion Solutions [18] HYSL	30.10	1.9	6.3	17.4	12.7	9/26
Honeywell HON	38.60	1.8	-6.5	-1.7	11.0	9/26
Cooper Tire & Rubber CTB	16.75	2.3	-15.6	-11.0	-11.6	9/26
Anheuser-Busch BUD	44.03	0.0	-4.2	-0.4	-0.7	10/3
Symmetry Medical SMA	22.77	-0.3	-4.8	-17.7	-6.7	10/3
Headwaters HW	35.99	2.7	-12.1	1.7	7.0	10/3
Check Point CHKP	23.50	3.5	-5.7	-13.0	-14.3	10/10
NuVasive NUVA	18.86	-0.6	-10.1	-3.0	5.4	10/10
Medis Technologies MDTL	17.90	0.3	-8.0	-16.2	31.3	10/10
Cheniere Energy LNG	35.27	5.9	4.7	7.6	15.2	10/17
Blue Nile NILE	32.35	2.2	13.1	23.3	7.4	10/17
Encysive Pharma. ENCY	10.34	-1.9	-3.3	-18.7	-57.7	10/17
PNC Financial PNC	55.16	1.9	13.3	15.6	19.4	10/24
IDT IDT	12.12	1.0	-3.8	-4.3	-7.9	10/24
Shire SHPGY	34.39	0.3	9.0	26.3	34.3	10/24
Biocryst Pharma. BCRX	14.15	8.3	-14.1	41.3	22.3	10/31
SulphCo SUF	4.50	0.2	-11.3	333.3	96.7	10/31

COMPANY NAME / SYMBOL	CLOSING PRICE THURSDAY	PERCENT CHANGE 1 DAY	1 MO.	3 MO.	6 MO.	ISSUE DATE
BearingPoint BE	6.90	-1.3	6.5	17.1	26.8	10/
USG USG	45.49	-1.6	8.2	35.9	80.7	11/
Advanta ADVNB	27.65	2.6	10.8	22.9	39.9	11/
Southwest Airlines LUV	15.44	2.0	6.4	5.7	6.3	11/
Ethan Allen Interiors ETH	34.30	-1.0	11.7	16.4	29.5	11/
Wyeth WYE	44.70	0.7	-3.4	4.8	9.8	11/
First Marblehead FMD	25.10	5.7	33.5	28.5	93.7	11/
Capital One Financial COF	80.58	0.3	4.8	5.7	8.3	11/
United Technologies UTX	52.88	1.1	4.8	8.0	25.1	11/
Salix Pharmaceuticals SLXP	19.16	0.1	-2.7	-9.7	-29.9	11/
SBA Communications SBAC	17.40	1.5	3.1	26.4	30.6	11/
Laserscope LSCP	22.14	1.6	7.6	8.4	-6.1	11/
Interpublic Group IPG	9.69	1.7	1.4	3.4	-1.2	11/
Green Mountain Coffee GMCR	38.49	3.5	6.7	5.1	7.3	12/
Federal Realty FRT	65.24	0.5	-4.8	7.6	-0.8	12/
Genco Shipping GSTL	16.70	1.3	2.3	-1.7	-0.8	12/
Liberty Media [19] L	7.73	0.9	1.8	6.7	11.8	12/
Spectranetics SPNC	11.00	3.0	2.3	4.6	16.8	12/
Sohu.com SOHU	19.64	2.8	-6.6	12.4	29.4	12/
Expeditors Intl. [20] EXPD	34.83	-0.2	-2.8	11.1	35.8	12/
Acacia Technologies ACTG	6.90	3.0	10.7	20.3	77.8	12/
Sonus Pharmaceuticals SNUS	4.40	7.5	40.7	25.0	17.5	12/
D.R. Horton DHI	11.60	-0.6	4.6	8.4	26.7	12/
Montpelier Re Holdings MRH	18.02	-0.1	6.9	-9.2	-8.9	12/
Western Digital WDC	14.96	2.3	44.1	34.8	21.4	12/

Data: *BusinessWeek*, Bloomberg Financial Mar

1. Split 4/10/06, 2:1
2. Split 1/6/06, 2:1
3. Acquired by EAS Group 10/25/05
4. Short, acquired by Federated Department Stores (FD) 8/30/05
5. Acquired by Johnson & Johnson 2/21/06
6. Split 5/30/06, 2:1
7. Split 8/29/05, 2:1
8. Split 10/24/05, 2:1
9. Split 12/16/05, 2:1
10. Split 3/1/06, 3:2
11. Acquired US Airways 9/27/05, ticker changed to LCC
12. Ticker change from AIX to AIXD 4/18/06
13. Acquired by Bank of America (BAC) 1/3/06
14. Split 4/5/06, 3:2
15. Acquired by West Corp. (WSTC) 4/5/06
16. Split 1/13/06, 2:1
17. Split 5/26/06, 2:1
18. Split 12/20/05, 3:2
19. Delisted 5/10/06, last traded 5/9/06
20. Split 6/26/06, 2:1

The Best...

COMPANY/SYMBOL	RETURN
ONE DAY	
Misonix MSON	10.8%
IMAX IMAX	9.5
ONE MONTH	
Western Digital WDC	44.1
Sonus Pharmaceuticals SNUS	40.7
THREE MONTHS	
Sulphco SUF	333.3
Energy Conversion Devices ENER	95.7
SIX MONTHS	
America West AWA	129.9
Sulphco SUF	96.7

...And the Worst

COMPANY/SYMBOL	RETURN
ONE DAY	
May Dept. Stores MAY*	-12.2%
Arrowhead Research ARWR	-3.3
ONE MONTH	
May Dept. Stores MAY*	-35.4
WPT Enterprises WPTE	-34.8
THREE MONTHS	
WPT Enterprises WPTE	-70.4
Barrier Therapeutics BTRX	-51.2
SIX MONTHS	
WPT Enterprises WPTE	-71.4
Encysive Pharmaceuticals ENCY	-57.7

*Loss on

ALETA FORCIONE DOESN'T HAVE A GREEN THUMB.
IN FACT, IF THERE WERE A COLOR DARKER THAN BLACK,
SHE'D HAVE THAT COLOR THUMB.

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IRAQ Today's bulletproof materials can't block every kind of blow

Body Armor Fit For a Superhero

New, high-tech "liquid" gear could keep troops, police, and prison guards safer

BY MICHAEL ARNDT

IT SEEMS CRAZY, ROBERT R. Schiller admits: the notion that you could shield yourself from bullets, shrapnel, and knives by donning the equivalent of a wet suit. But by early next year the president and chief operating officer of Armor Holdings Inc. aims to be selling what he describes as "liquid armor"—garments constructed from layers of tough fibers and fluid polymers—to prison guards. By the end of 2007, he hopes, police and maybe soldiers will begin wearing the company's new protective gear as well. For the corrections market in particular, Schiller says, "it has the potential to be a breakthrough product."

Today's versions of body armor are composed mostly of 20 to 30 layers of synthetic fibers. And while there is no question the death toll for American troops in Iraq would be far higher without it, the gear is bulky and can't stop high-velocity bullets, for example, or all bomb fragments. Even as DuPont was field-testing the original Kevlar jackets in the early 1970s, researchers were hunting for lighter, tougher ballistic fabrics. Since then, companies have investigated a chemist's kit of exotic materials, from cloned spider silk—a wonder of lightness and strength—to newfangled sheets of carbon nanotubes that are among the toughest structures in nature. Israeli researchers at one company, ApNano Materials Inc. in New York, have shown off a breastplate of nanometals said to be five times as strong as steel.

Armor Holdi product is diffe from all of the ot Developed by man Wagner, a fessor of chem engineering at the University of I ware's Center for Composite Mate it's a mix of polyethylene glycol, a mer found in laxatives and other sumer products, and nanobits of silic purified sand. Together they produ "sheer-thickening liquid" that sti instantly into a shield when hit har an object. It reverts to its liquid state as fast when the energy from the pr tile dissipates.

LIKE PEANUT BUTTER

INITIALLY, WAGNER AND his collab tors envisioned armor that coul spread on a person, almost like pe butter on bread, says Eric Wetzel, searcher at the Army Research Labo ry in Aberdeen, Md. But in tests co-s sored by the Army Lab, they found the materials worked best when pai on Kevlar in ultrathin coats. By hol the fibers tight like a flexible glue compound spreads out the impact blow better than fibers alone. "The se in the past has been for stronger stronger filaments," says Wetzel. "W tried to change how the fabric inte with the projectile."

The liquid has other pluses. It's li than Kevlar and other widely used fa That means Armor Holdings' new in which the substance would be s wiched between layers of ballistic f might be lighter than current vers which weigh four pounds or more. I should be cheaper to manufacture, Schiller. The Jacksonville (Fla.) com wants to continue to sell entry-level ments for $500 to $600.

Any minuses? No one knows yet well the material will hold up after of wear and tear.

Armor Holdings, which bough rights to Wagner's discovery last F ary, pulls in the bulk of its $1.64 b in annual sales from selling vehic mor to the U.S. While liquid armor s tailor-made for comba sonnel or police, the pany is initially targ prisons because the resists punctures. means it can protect g from stabbings, some even a top-of-the-line letproof vest can't do.

Protection in an Instant

Compared with bulletproof vests made of synthetic fibers such as Kevlar, "liquid armor" made of polymers and nanobits of silica offers the following advantages:

STRONGER The liquid, which solidifies on impact, excels at blocking bullets

MORE COMFORTABLE The material is light, flexible, and easier to wear

PUNCTURE-PROOF The fabrics protect against knives—a big plus in body armor

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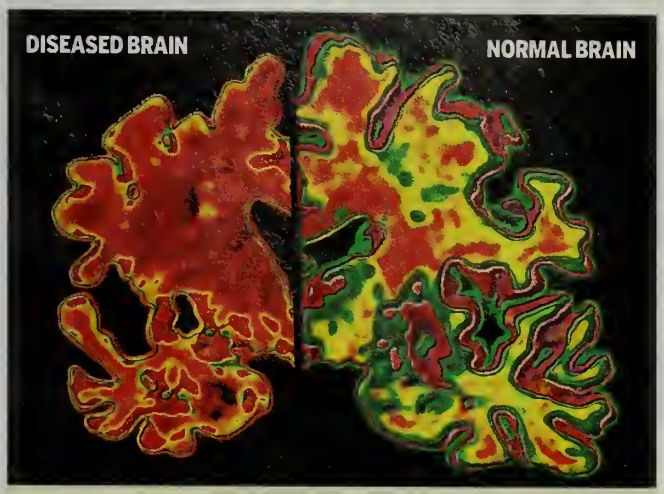
TED BY
'HERINE ARNST

NOVATIONS

corny clothes
d sponge
tectors

Scientific meetings are not ctly the most fashion-vard events. But the ech community tried to nteract the geekster look t least one such confab, recent World Congress on ustrial Biotechnology & processing in Toronto, by ting on an haute couture ion show. The technology Industry anization (BIO) showcased dresses made from Ingeo, the first fiber spun from corn syrup. Introduced by Cargill three years ago, Ingeo is a biodegradable polyester made from renewable crop sources, unlike petroleum-based polyesters.

» Foreign objects get left in patients' bodies in one out of every 10,000 surgical operations, and two-thirds of those objects are nges. To guard against h mishaps, doctors at nford University tested a ndheld scanner that can ect sponges tagged with io frequency identification ps. In trials with eight senting patients, the nner detected all of the nges that were purposely behind. They reported the ults in the July issue *Archives of Surgery*.



DIAGNOSIS

THE EYES: WINDOWS INTO ALZHEIMER'S?

THE FIRST ESTIMATE of the worldwide costs of Alzheimer's disease, made by Sweden's Karolinska Institute, puts the total at $248 billion this year, which it says is more than the gross domestic product of all but 18 of the world's 216 countries. Researchers are hoping to lessen this burden by coming up with ways to detect and treat the disease in its earliest stages.

Currently, Alzheimer's can be diagnosed only at an advanced stage. Studying mice genetically engineered to develop the condition, a team from Harvard Medical School discovered last year that the plaque that collects in Alzheimer's-afflicted brains also accumulates in the eyes.

At a recent medical meeting, the Harvard team reported that an infrared light beamed into the eyes of Alzheimer's mice could detect this plaque at 10 months, long before it could be found in the brain or eye by conventional methods.

CUP OF JOE

STIR AWAY THE CAFFEINE

YOU'RE AT A dinner party, dessert is on the table, and coffee is being passed around. You want some, but you'd prefer to avoid the caffeine, and decaf just doesn't taste the same. Now, DeCaf Co., a privately held startup in San Francisco, has a novel solution. The company has developed a stirring stick that draws the caffeine out of a cup of coffee, tea, or soda.

The sticks make use of a technology called molecularly imprinted polymers (MIPs). These polymers behave like synthetic antibodies, attracting the caffeine molecules and pulling them out of the liquid. When one of these sticks, which look something like tongue depressors, is swizzled in coffee, it can remove up to 70% of the caffeine, says DeCaf. The longer you stir, the more caffeine comes out.

DeCaf CEO Mel Stuckey says he hopes to license the product to a food or beverage giant. The company is in the process of getting its method verified by the Food & Drug Administration.

–Sarah Lacy

DEADLY SEA

A SUPERFUND SITE HELPS FIGHT CANCER

THE POISONOUS WATERS of a huge toxic lake in Butte, Mont., may turn out to be the mother lode for disease-fighting compounds. The Berkeley Pit Lake, part of the nation's largest Superfund site, was a mile-wide open-pit copper mine before it was abandoned in 1982. It is now filled with 30 billion gallons of metal-contaminated, acidic water that is deadly to most aquatic life. But scientists from Montana Tech of the University of Montana, also in Butte, have discovered in its dark waters a number of microorganisms called extremophiles that could be the basis of new drugs.

The team, led by chemist Andrea A. Stierle, reports in the July 7 issue of the *Journal of Organic Chemistry* that one such extremophile, a species of *Penicillium* fungi, exudes an acid that is active against ovarian cancer cells isolated in test tubes. Stierle's team earlier discovered microbial substances that proved effective against lung cancer cells in test tubes, and blocked nerve cell receptors that can cause migraine headaches. The research is funded by the National Institutes of Health.

Tee It Up, Ladies

Women-only golf clinics offer a nonthreatening way to get into the game. **BY ADRIENNE CARTER**

AS SOMEONE WHO COMES from a family of golfers—my mother has even made three holes in one—I should have developed an early affinity for golf. Yet the closest I've come to playing a round was in the arcade game Golden Tee. ¶ Then I moved to Chicago and bought a condo next to a public course on Lake Michigan. Watching golfers whack their drives and try to will their putts into the cup, I had two thoughts: "That looks like fun," and, "Where do I begin?"

A logical place was at one of the LPGA Golf Clinics for Women run by JBC Golf, a Cambridge (Mass.) golf-event marketing company founded by former pro golfer Jane Blalock. These one-day sessions aim to demystify golf for women from the business world. Women have long since realized what men have always known—that you can forge important business bonds on the course—but for beginners the game can be intimidating. These clinics teach the basics in a nonthreatening way. "You don't have to be a great player as long as you know the etiquette, know how to move the game along," says Melanie Bedrosian, a coordinator for JBC Golf (jbcgolf.com).

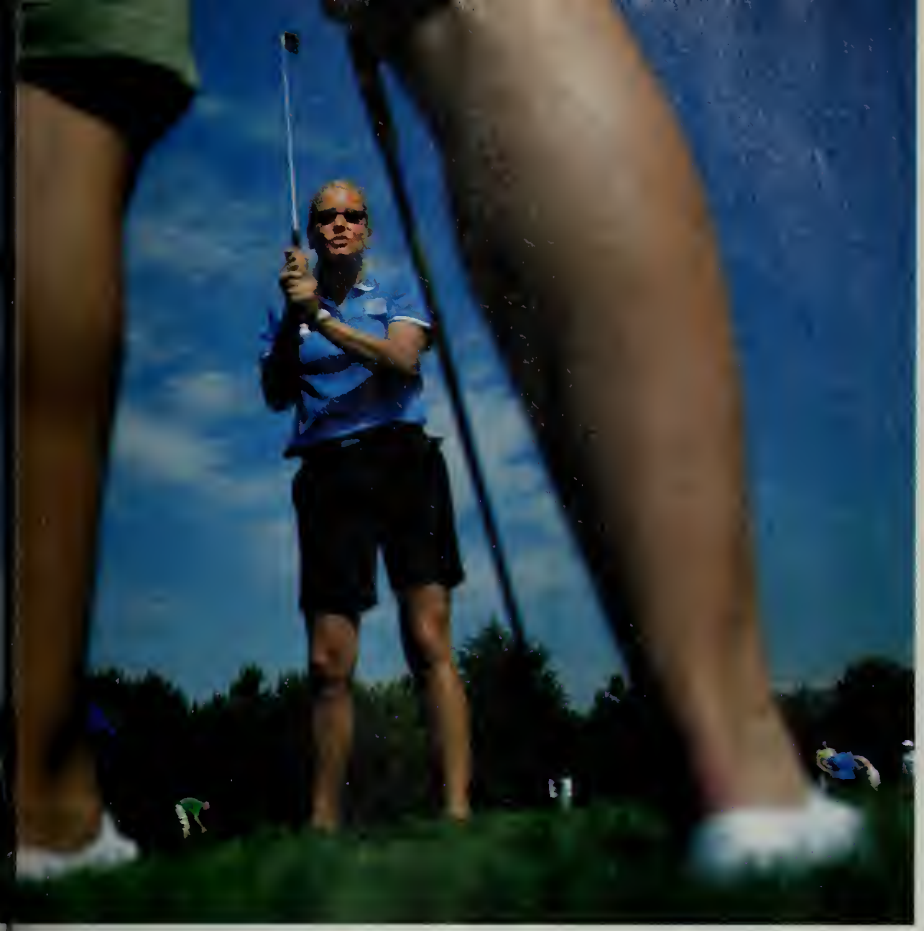
JBC charges $275 per person for a day at one of 15 clinics around the country. It's not the only game out there. The Executive Women's Golf Assn., with 115 chapters in 39 states and two in Canada, offers classes as well (ewga.com). A recent seminar in Portland, Ore., for example, focused on the rules of golf. Pri companies such as New Yo GolfingWomen (golfingwomen.com) Tempe (Ariz.)-based Golf For C (golfforcause.com) organize women- events for companies and busi schools. Part of GolfingWomen's agen to teach women how to get invited to outings. One tip, says Executive V President Adrienne Wax, is to keep paraphernalia in your office to s conversation with colleagues and let t know you're interested in playing.

My clinic took place at the White E Golf Club in suburban Naperville, Ill. 140 or so women were divided into a 20 groups of four skill levels: r played, beginner, intermediate, and vanced. I happily embraced my "r

Putting On A Clinic

At LPGA Golf Clinics for Women the aim is to demystify the game for businesswomen. Even raw beginners get out on the course in one day

SHORT GAME Players begin their day with a putter on the practice green at White Eagle Golf Club in Naperville, Ill.



GET A GRIP LPGA instructor Emily Barkoozis gives students pointers on the practice tee

ed" status and joined the other four
ien in my group, including a patent
er, a consultant for Pricewaterhouse-
ers, and two women in the alcoholic
rage industry.

EET SPOT

INSTRUCTOR, Emily Barkoozis, a
ier competitive swimmer who be-
e a golf pro seven years ago, was
dly and frank. Like most of the LPGA
ning pros in the program, the 31-year-
Barkoozis works at a local club.
ughout the day she shared her per-
l golf stories. She recalled the time she
matched up with two men who quiet-
mplained about being paired up with
man. She shut them up by knocking
ball straight down the fairway.

We spent the first part of the day on the fundamentals: putting, chipping, and driving. Starting out on the putting green, I quickly realized I didn't need quite so much power to sink a shot. From there we moved on to other parts of the short game. We learned about the proper stance and club selection, which depends on where the ball lies (in deep grass or a sand trap, say) and its distance from the hole.

I was most humbled at the driving range. Here our instructor spent time with each of us, correcting our individual problems. Although I knew the right way to hold the club, I flubbed my way through a number of shots. It turns out I have a nasty habit of overswinging—that is, bringing the club too far back on the backswing. I also tend to hit the ball with the front edge, or toe, of the club, sending it off to the right rather than straight down the fairway. To fix the problem, my pro told me I needed to hit the ball in the center, or sweet spot, of the club face.

After a short demonstration by Blalock and a buffet lunch, we hit the course to play a scramble. In this format, each player takes a shot, then the group decides which ball landed in the best position and takes the next shot from that spot. This took away the pressure of having to make a good shot every time we swung. Of course, it was usually our instructor's shot that won out.

During our two hours on the course, we also got a handle on the etiquette, from who putts first on the green to the importance of keeping quiet during someone's shots. Our pro emphasized pace of play—the idea that you should keep the game moving. We talked about the conventions of conducting business on the course. Some say it's verboten to talk shop while playing, and that business should wait until cocktails at the 19th hole. Others argue you should take your cues from your fellow players. If your client wants to talk about a deal, by all means talk.

After slogging through almost nine holes, we headed to the clubhouse for drinks. It gave everyone a chance to unwind, meet other career women from the area, and exchange business cards.

Admittedly, one daylong session does not a real golfer make. But I've vowed to get to the driving range at least once a week and take more lessons. By the end of the summer, 18 holes, here I come.

TIME
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LET 'ER RIP
After running through the basics, new golfers finally get a chance to air it out on the range

FORE
Students learn course etiquette—from who putts first to keeping things moving—while playing in a scramble format

New Life for those Dusty Old LPs

The Laser Turntable brings out the best in ancient vinyl, but it will cost you. BY JAY GREENE

FOR YEARS, A WONDERFUL and really obscure song, Bobby Woods's *Love is My Business,* would often pop into my head. Woods recorded the song in 1959, and I found it on a vinyl record compilation of songs from his label, Ace Records, in a London shop about 20 years ago. But as I switched from records to compact discs, Bobby Woods vanished from my collection. The album never made the transition to CDs, iTunes, or even file-sharing networks, and my copy was relegated to a box in the basement.

Then I took ELP Corp.'s Laser Turntable home for a spin. This $15,000 gizmo plays old vinyl records much the way CD players read compact discs. Slip a vinyl platter into the Laser Turntable's tray and a laser reads the grooves. After an easy 15-minute setup, I ran down to my basement to dig through boxes of old records. In a few minutes, I was listening to Woods croon about trying to win back his love.

Of course, turntables never really went away. Retailers and Web sites catering to audiophiles continue to stock the limited number of models that remain in production. Their owners often brag about the "warmth" of the sound they get from analog vinyl recordings that they claim has yet to be reproduced with digital technology. Perhaps they're right.

For $15,000, you get a stylus-free player that adjusts for scratches

But in the 1980s I joined the masses, discarding my turntable for a CD player. I got tired of replacing the belts and needles. I also fretted about cherished albums becoming too scratched or warp play. Most record stores sto stocking LPs as interest wa CDs were easier.

The Laser Turntable m vinyl viable again. What's so about the device is that it m records just as easy to play as It's a snap to skip from one to the next and even pause i middle of a song or scan thr it. What's more, you can with a remote, sitting in a lo chair across the room. Try that your old turntable.

The device uses five lasers t tect the grooves, position the lasers, and pick up sound. And unl traditional turntable stylus, it do wear on your records. The lasers can adjust for warps and scratches so re don't skip or repeat.

BIGGER THAN A BREAD BOX

THE TECHNOLOGY was actually d oped 20 years ago but never found a ket because of technical challenges a prohibitive cost. Each machine is by hand, so don't expect the falling p typical in consumer-electronic proc ELP, based in Saitama, Japan, has about 1,000 units, 80% of them in J It recently found a U.S. distributor, Turntable Ltd. (laserturntable.com)

As nifty as it is to reacquaint yo with your record collection, a few ca are in order. You'd think ELP would come up with a sleek design befittin audiophile's dream, which costs equivalent of a downpayment on a home. Instead, it's a bulky box, nea inches square and towering 7 in. with altogether pedestrian buttons.

While the Laser Turntable can pl rpm records and 45s in addition t standard 33⅓ rpm platters, its lase only read black vinyl. I was really ea play a limited edition Elvis Costello disc that Stiff Records released in 197 it was pressed on clear vinyl and the Turntable had no clue what to do wi

Last, remember that a laser everything. That means a bit of du sometimes come through your spe with a pop. For the review, ELP pro me with a $500 record vacuum, seems a must-have for the turntabl

With a clean record and an ar lasers to read it, Bobby Woods sounded so good. ■

BusinessWeek online To learn how to t your old vinyl records into digital record go to businessweek.com/extras

PEOPLE WHO MAKE GREAT COMPANIES WORK

Rachael Hackbarth puts the fresh in Fresh Express, America's top producer of fresh packaged salads. What keeps the salads fresh in their packages without additives or preservatives? The special bag that controls the amount of oxygen that enters and leaves. As nutritionist and technical director of products, Rachael tests and optimizes different vegetable mixes with various bag compositions. Toughest vegetables to work with? "Tomatoes." Most popular? "Hearts of romaine (above) and spinach."

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BY ROBERT PARKER

A Taste of California's Future

NY OF THE VINEYARDS and wineries of California's Central Coast are still ıng, but their potential to produce great pinot noir, chardonnay, and ah is enormous. In a decade, the top viticultural areas of Santa Barbara, Santa Rita Hills, and the limestone hillsides west of Paso Robles will be well known as the Napa and Sonoma Valleys. Following are some of the ion's noteworthy current syrah releases.

ille 2003 Syrah Estate
nts. This deep ruby syrah possesses of a pinot noir sensibility. It has a ne style with hints of sweet black ts, ripe cherries, and flowers in a m-bodied, velvet-textured, complex, al format. Enjoy over the next four to five $20

s-Bolus 2003 Syrah
nts. A sexy red offering with a gorgeously flowery, blackberry-and-cassis-filled et and hints of charcoal, licorice, and . Velvety, with big, chewy, rich, fleshy s, low acidity, and wonderful purity, this ess seductress should drink well over the ve to seven years. $25

n Wines 2003 Syrah
nts. Exhibits good ation of tannin with of flowers, berries, nts, spice, e, and a hint od. Initially nt, it opens beautifully both aromatically and on the palate. Will drink well over four to five years. $28

Stolpman Vineyards 2003 Syrah Hilltops Estate
93 points. This 100% estate syrah emerges from ridgetops that are the most stressed parts of the vineyard. It offers rich, concentrated blackberry, acacia flower, charcoal, and subtle background wood notes. Powerful as well as impressively pure and elegant, this is a wonderfully symmetrical effort with tremendous harmony, depth, and persistence. Drink it over the next five to nine years. $33

Fess Parker Winery 2002 Syrah Rodney's Vineyard
92 points. A sweet perfume of Valrhona chocolate mixed with espresso, blackberries, cassis, camphor, and flowers. The aromatic display is followed by a wine of enormous density, richness, and balance, with good acidity as well as sweet but noticeable tannin. This wine will age beautifully for 10 to 12 years. $35

Andrew Murray Vineyards 2003 Syrah Westerly Vineyard
91 points. The opaque ruby/purple color is accompanied by aromas of charcoal, blackberries, cassis, and licorice. The wine has tremendous purity, full-bodied power, and concentrated as well as elegant and harmonious flavors. Consume it over the next seven to eight years. $35

Fess Parker Winery 2002 Syrah The Big Easy
93 points. This dense, purple-tinged, explosive effort exhibits huge notes of creosote-infused chocolate, blackberries, cherries, and licorice. Full-bodied, with marvelous fruit, a seamless texture, and a long finish. You can enjoy this wine over 10 to 12-plus years. $36

Garretson Wine Co. 2003 Syrah Mon Amie Bassetti Vineyard
90 points. At 16.8% alcohol, this deep purple syrah is no shy wine. Still, it has enough acidity to provide balance. Aromas of crème de cassis, licorice, scorched earth, and oak are followed by a powerful, long, mouth-filling syrah that should drink well for seven to eight years. $50

Visit **www.eRobertParker.com** for the Internet's most active wine bulletin board, tens of thousands of tasting notes, or to order his recent book, *The World's Greatest Wine Estates: A Modern Perspective*. You can also subscribe to Parker's newsletter, *The Wine Advocate*. Request a sample copy at: *The Wine Advocate*, P.O. Box 311, Monkton, MD 21111.

Wines rated from 96-100 are extraordinary; 90-95, excellent; 80-89, above average to very good. For more Parker picks, go to businessweek.com/extras

EDITED BY MONICA GAGNIER

BAKED GOODS

SWEET STOWAWAYS

FOR ANYONE WHO THINKS desserts should come by the suitcase-full, B&G Cookie Co. has a sweet idea. Its chocolate chip cookies, brownies, and other homebaked goodies are packed in miniature brown valises, complete with pink ribbon wrapping and luggage tags with the recipient's name and address. The packaging and contents are the products of sisters Beverly Griffith and Grace Evans, who started baking together as teenagers at a San Diego restaurant 20 years ago. They offer six travel-themed packages, including the "Overnighter," one valise with six cookies or brownies for $18, and "To the Moon," three stacked valises holding 36 goodies for $108 (bandgcookie.com).

–Aili McConnon

ART

Do a Double Take

IT'S AN ECLECTIC MIX—Jimi Hendrix and Jasper Johns, Elvis Presley and Pablo Picasso. Seattle's Experience Music Project (EMP) is using space in its Frank Gehry-designed museum for art that has nothing to do with its rock 'n' roll mission. DoubleTake: From Monet to Lichtenstein showcases 28 works from the collection of the museum's billionaire owner, Microsoft co-founder Paul Allen. The show, which runs through Sept. 24, marks the first time Allen has shown the works to the public.

The exhibit gathers a remarkable assortment of masterpieces from artists spanning styles and eras. Curator Paul Hayes Tucker has used pairings to draw comparisons between pieces, connecting works by Willem de Kooning and Claude Monet, Edgar Degas and Eric Fischl, and Nan Goldin and Paul Cézanne.

For $33, you get admission to the mate gallery where DoubleTake is housed, access to the EMP, where yo can learn what it's like to be a rock s and a pass to the Science Fiction Mu um & Hall of Fame, which is in the s building. If you only have time for t art, you can get into DoubleTake for (emplive.org).

–Jay G

POP ART Roy Lichtenstein's 1962 painting, *The Kiss*

TRAVEL INSURANCE

You're about to jet off to Aruba when your boss reels you back into the office for an assignment that can't wait. Your vacation might be ruined, but you don't have to take a financial hit. A new travel insurance plan from Access America covers people who have to scrap a getaway because of work. The BizPack option, at $19 per adult, is an add-on to Access America's comprehensive travel insurance policies, which run 5% to 8% o trip's cost and cover cancellation for such reasons as injury or severe weather. You must purchase the policy within two weeks after paying your initial trip deposit. If a merger, emergency, or a mandatory call to work scotches you plans, get a note from your boss ar Access America will issue a chec whatever trip costs aren't refundable.

–Greg H

HEN THE INFORMATION NEVER STOPS, NOTHING CAN STOP YOUR BUSINESS.

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The $700 Used Book

Why all the buzz about Seth Klarman's out-of-print investing classic? **BY ROBEN FARZAD**

HARPER LEE'S 1960 NOVEL *To Kill a Mockingbird* quickly became a modern classic, but except for a few essays, Lee never published again. J.D. Salinger secluded himself in New Hampshire in 1953 following the success of *The Catcher in the Rye*. A few more novels and short stories followed over the next decade, but he has been mum since. ¶ At least with Lee and Salinger, there's no problem finding their works. Not so for the sole book written by hedge fund manager Seth Klarman. His 1991 work, *Margin of Safety: Risk-Averse Value Investing Strategies for the Thoughtful Investor,* came and went without much notice at the time and is long out of print. Klarman holds the copyright but has never revised or even reprinted it.

Still, over the past few years this work has taken on iconic stature among value investors. Originally listed at $25, the title trades for top prices on the used-book market. About a half-dozen copies are for sale online: The best deal is $700 from a seller at Amazon.com. Another vendor offers it for nearly $2,500.

There are other ways to get hold of it. One entrepreneur even rented it out on eBay for $75 a week, promptly drawing a customer. University libraries report it as one of their most wait-listed titles as well as one most claimed as lost. (Maybe borrowers figure they can replace it at face value.) All told, just 262 libraries worldwide report having a copy, according to the Online Computer Library Center, an international database that includes about 95% of academic libraries and 75% of public libraries.

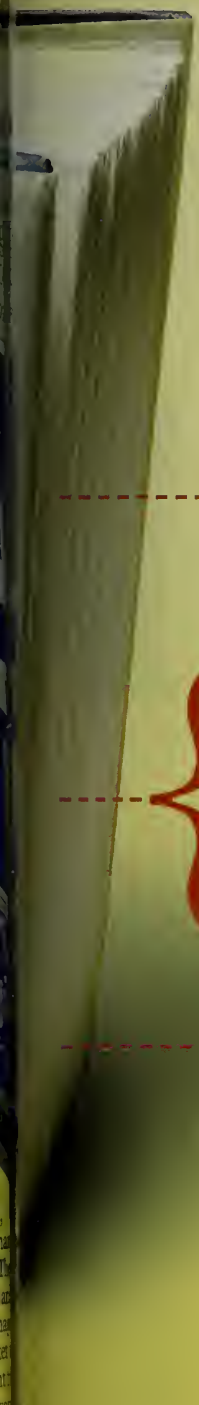
KLARMAN He manages $6.2 billion

The 249-page book is especially hot among those seeking jobs with value-oriented investment firms. "You win serious points for talking Klarman," says a newly minted MBA who got his hands on a copy prior to a late-round interview with a top mutual fund firm. "It's pretty much assumed that you've read Graham and Dodd and Warren Buffett." (Benjamin Graham and David Dodd's 1934 work, *Security Analysis,* is a seminal book on value investing, while Buffett's annual letters to shar holders are considered gospel.) "Th belongs in the category of Buffett an ham," says Oakmark Funds manag Nygren, a collector of stock market

Klarman declined to comment f story. But by reading the book, exar regulatory filings, and reviewing l cent reports to shareholders, we we to piece together some of his think

Why does anyone care what Kl wrote 15 years ago? The author, nov one good investor. Klarman earn MBA at Harvard Business School ir graduating near the top of his cl group of wealthy families took noti gave Klarman $27 million to m which was the start of his firm, the B based Baupost Group. Between its ary, 1983, inception and the end o

(L-R) PHOTOGRAPHS BY RICHARD HOWARD/TIME LIFE PICTURES/GETTY IMAGES; NICHOLAS EVELEIGH



Words from a Reticent Guru

Some investors rank Klarman's writings with those of Warren Buffett:

On Value Investing:
It can be a very lonely undertaking. A value investor may experience poor, even horrendous, performance compared with that of other investors or the market as a whole during long periods of market overvaluation.

On Creating a Margin of Safety:
By always buying at a significant discount to underlying business value, and giving preference to tangible assets over intangibles....By replacing current holdings as better bargains come along. By selling when the market price of an investment comes to reflect its underlying value and by holding cash, if necessary, until other attractive investments become available.

On Successful Investors:
...[they] tend to be unemotional, allowing the greed and fear of others to play into their hands.

, Baupost's largest and oldest part-
up posted a cumulative return of
% after fees. During the same period,
andard & Poor's 500-stock index was
17%, with dividends reinvested.
upost manages $6.2 billion of assets
s nine partnerships, but Klarman is
essible even to the well-heeled: The
turns away new investors. When it
still accepting clients, you needed a
al from an existing client before
ost would take your money.
ce Klarman and his book are hard to come by, here's a quick summary. The term "margin of safety" refers to the cushioning, or wiggle room, that investors should build into what they pay for a security. He doesn't claim to have invented the term, which comes from Graham & Dodd. "How can investors be certain of achieving a margin of safety?" writes Klarman. "By always buying at a significant discount to underlying business value, and giving preference to tangible assets over intangibles....By replacing current holdings as better bargains come along. By selling when the market price of an investment comes to reflect its underlying value and by holding cash, if necessary, until other attractive investments become available."

Although definitions of "underlying value" abound, Klarman's interpretation opts for a more no-nonsense view that's shorn of intangible assets such as goodwill. "Since investors cannot predict when values will rise or fall," he writes, "valuation should always be performed conservatively, giving considerable weight to worst-case liquidation value as well as to other methods."

DISTRESSED PRICES

AS AN INVESTOR, Klarman often seeks opportunity in idiosyncratic investments such as distressed securities and bankruptcy workouts. In the book, he describes buying Texaco bonds in the wake of the company's sudden 1987 bankruptcy. What prompted the filing was the loss of a multibillion-dollar lawsuit, not insolvency. In the ensuing panic, investors dumped the bonds, and Klarman got them at distressed prices. His bet was that Texaco would make good on the debt, and he was right.

In the same spirit, Baupost's latest Securities & Exchange Commission filings show that the firm has a position in John B. Sanfilippo & Son, a nut-and-candy distributor whose shares plunged last year on concerns that it might violate debt covenants. There's no way to know what Klarman paid, but the stock did trade for far below book value.

Most names in Baupost's portfolio are obscure, except for its largest holding, News Corp. The firm has stockpiled at least $230 million worth of the media giant's A- and B-class shares. What's the play? Media companies are often sought by value investors. They can produce bountiful cash flows even when earnings look pale.

In his latest shareholder letter, Klarman reiterates one of the book's tenets: Value investors must be overweighted in patience. In the past, Klarman has parked as much as half his portfolio in cash, earning a few percentage points until he finds investments with enough margin of safety to deploy it. Rather than chase stocks and bonds, he waits for them to come to him at prices he's comfortable paying. That's a lesson worth far more than $700.

BusinessWeek online Want to see what Seth Klarman is investing in? Go to businessweek.com/extras

BY GENE G. MARCIAL

COMPARED WITH ITS PEERS, BEAR STEARNS LOOKS UNDERVALUI

BALLY'S FINANCIAL REPORTS ARE OVERDUE, SO NO PAYOFF YET.

MORE TAG TEAMS BETWEEN BIG PHARMA AND EMISPHERE.

Bullish on Bear Stearns

VOLATILITY IS A BROKER'S FRIEND, and the market's recent swings have produced outsize gains for some of the biggest brokerages. "Shares of the group have outrun the rest of the financial sector this year," notes Bernie Schaeffer, president of Schaeffer's Investment Research. The uptick in mergers and acquisitions has helped. His top pick is Bear Stearns (BSC), fifth-largest in the industry. "It's the most undervalued," he argues. Bear Stearns, known for its strength in fixed-income trading, mainly in mortgage and high-yield securities, trades at 136.40 down from nearly 148 on Apr. 20, but Schaeffer expects it will hit 200 in a year. It changes hands at just 10 times 2006 estimated earnings, while Goldman Sachs and Merrill Lynch both trade at about 12 times earnings, notes Schaeffer. Although Bear's second-quarter results beat forecasts, naysayers argue that its mortgage business is bound to slow because of rising interest rates. But Meredith Whitney of CIBC World Markets, who rates the stock "overweight," notes that it has performed better this year than most other large-cap brokers because its mortgage business exceeded all forecasts. Another bull, Michael Hecht of Bank of America, says "strong profitability" will continue to "narrow the valuation gap vs. its peers." Hecht figures Bear Stearns will earn $13.79 a share this year and $14.15 in 2007, vs. $10.31 in 2005.

PEAKS—AND NOW A VALLEY

Bally: Better Grades After It Does the Homework?

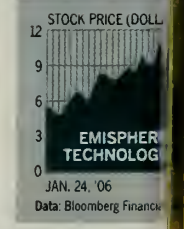
BALLY TECHNOLOGIES (BYI) has plenty going for it as the second-largest maker of slot and lottery machines. But a huge thorn is poking the stock: Bally hasn't reported quarterly financial results since the June, 2005, period. It faces delisting by the New York Stock Exchange unless it files the late reports by September. Little wonder that of 14 major analysts who follow it, four rate it a "sell," including Citigroup and JPMorgan Chase, and six are "neutral." Yet three tag Bally a "buy," despite the regulatory troubles. They say sales are going well, and they expect the financial statements will be filed before the deadline. The stock will then perk up, says David Bain of investment firm Merriman Curhan Ford, one of those who rate it a buy. He puts the value of the stock, now at 15.75, at 20, based on Bally's turnaround and his earnings estimate of 34¢ a share for 2006 and 62¢ for 2007, vs. a 3¢ loss in 2005. Some pros also see Bally as potential buyout bait. Lawrence Haverty of Gabelli Asset Management, which owns shares, says the company's strong cash flow and solid products are likely to attract bigger gaming device makers.

DOWN FROM A BOUNCE

Emisphere Dances with Giants

TINY BIOTECH Emisphere Technologies (EMIS) h attracted Big Pharma to team up on its products in clinical trials. On July 18, Roche Holding inke pact to use Emisphere's technology for oral formulatio Roche compounds. That's on top of its work with Emisphere's drugs for bone cancer. Emisphere is a pio in oral delivery of injectable drugs such as insulin. No is a partner on oral Calcitonin for osteoarthritis and osteoporosis. And a partner on oral insulin, which is scheduled to go into Phase 3 trials late this year, will be named in the next few months. Sanofi-Aventis, Merck, and Bristol-Myers Squibb are candidates, say analysts. The oral Calcitonin and oral heparin are in Phase 3 trials and could be on the market by 2010, and oral insulin in 2011. "The potential for gain far outweighs any downside risks, and we reiterate our 'buy' rating," says Adnan Butt of ThinkEquity Partners. His 12-month target for the stock, now at 7.04, is 15. Emisphere joined the Russell 2000 June. Andrew Forman of WR Hambrecht, which has d banking for the company, expects it to be in the black 2010, mainly from oral heparin sales and royalties on products, including oral insulin. He rates it a "buy."

GETTING UP ON ITS TOES



BusinessWeek online Gene Marcial's Inside Wall Street is post businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

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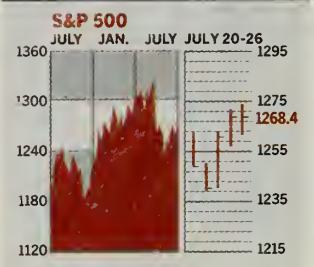


COMMENTARY

The markets were flat last week with the S&P, Dow, and Nasdaq changing less than 1%. But strong cross-currents in earnings reports made investors chary. General Motors showed turnaround momentum and the stock soared 12%, while United Parcel foretold a global business slowdown and lost 16%. The next big hope: takeover bids from LBO firms, like the one for HCA.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	JULY 26	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1268.4	0.7	1.6	3.0
Dow Jones Industrials	11,102.5	0.8	3.6	4.9
NASDAQ Composite	2070.5	-0.5	-6.1	-4.8
S&P MidCap 400	736.8	-0.5	-0.2	3.2
S&P SmallCap 600	359.2	-1.3	2.4	2.8
DJ Wilshire 5000	12,697.4	0.4	1.6	3.4
SECTORS				
BusinessWeek 50*	716.2	1.4	-3.5	-1.7
BW Info Tech 100**	364.5	0.8	-4.2	-0.5
S&P/Citigroup Growth	584.6	0.7	-2.0	-1.0
S&P/Citigroup Value	682.4	0.7	5.4	7.3
S&P Energy	437.3	2.8	17.3	20.0
S&P Financials	439.6	0.4	3.1	8.7
S&P REIT	173.8	-0.2	13.6	10.3
S&P Transportation	242.4	-11.2	-3.0	10.3
S&P Utilities	172.7	2.4	8.2	6.7
GSTI Internet	153.1	-3.6	-25.4	-10.1
PSE Technology	755.7	-0.1	-9.6	-5.9

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	JULY 26	WEEK	% CHANGE YEAR TO DATE
S&P Euro Plus (U.S. Dollar)	1657.8	2.2	9.7
London (FT-SE 100)	5877.1	1.7	4.6
Paris (CAC 40)	4943.0	2.0	4.8
Frankfurt (DAX)	5583.1	0.8	3.2
Tokyo (NIKKEI 225)	14,884.1	2.6	-7.6
Hong Kong (Hang Seng)	16,617.2	3.2	11.7
Toronto (S&P/TSX Composite)	11,879.6	2.2	5.4
Mexico City (IPC)	19,913.2	0.2	11.9

FUNDAMENTALS	JULY 25	WEEK AGO
S&P 500 Dividend Yield	1.88%	1.92%
S&P 500 P/E Ratio (Trailing 12 mos.)	16.7	16.5
S&P 500 P/E Ratio (Next 12 mos.)*	13.9	13.5
First Call Earnings Surprise*	4.66%	3.80%

*First C

TECHNICAL INDICATORS	JULY 25	WEEK AGO
S&P 500 200-day average	1265.4	1264.5
Stocks above 200-day average	47.0%*	41.0%
Options: Put/call ratio	0.85	1.08
Insiders: Vickers NYSE Sell/buy ratio	2.63	2.57

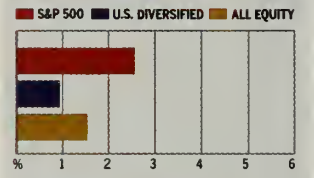
BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Home Entertainment	15.4	Agricultural Products	92.8
Integrated Oil & Gas	12.4	Steel	77.4
Gas Utilities	11.9	Divsfd. Metals & Mining	49.2
Power and Energy Traders	11.1	Oil & Gas Refining	48.3
Fertilizers & Ag. Chems.	11.0	Constr. & Engineering	43.4

WORST-PERFORMING GROUPS	LAST MONTH %	
Internet Retailers	-28.6	Tires & Rubber
Employment Services	-18.6	Homebuilding
Computer Retailers	-15.1	Internet Retailers
Trading Cos. & Distribs.	-14.4	Educational Services
IT Consulting	-14.3	Home Furnishings Rtlrs.

MUTUAL FUNDS

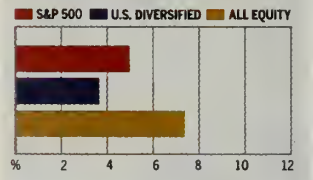
4-WEEK TOTAL RETURN

WEEK ENDED JULY 25



52-WEEK TOTAL RETURN

WEEK ENDED JULY 25



Data: Standard & Poor's

EQUITY FUND CATEGORIES 4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Latin America	12.1	Precious Metals	65.9
Utilities	6.1	Latin America	54.4
Real Estate	5.5	Diversified Emrg. Mkts.	29.1
Diversified Emrg. Mkts.	5.5	Japan	25.5
LAGGARDS		LAGGARDS	
Technology	-3.5	Technology	-3.9
Small-cap Growth	-1.2	Large-cap Growth	0.2
Japan	-1.0	Small-cap Growth	2.0
Mid-cap Growth	-0.9	Mid-cap Growth	2.4

EQUITY FUNDS 4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
DireXion L. Am. Bl. 2X Inv.	21.9	U.S. Global Invrs. Gold	102.6
DireXn. Emrg. Mkts. Bl. 2X	18.0	Midas	95.4
iShares MSCI Mxco. Idx.	15.3	U.S. Glbl. Invs. Prc. Mnls.	93.7
ProFds.UltEmerg. Mkts. Inv.	14.8	Van Eck Invrs. Gold A.	83.5
LAGGARDS		LAGGARDS	
DireXion Emrg. Mkts. Sht.	-20.0	Ameritor Investment	-72.7
ProFds. USh. Emrg. Mkts. Inv.	-16.9	American Heritage Grth.	-33.3
ING International Port S2	-11.6	ProFunds. Semicdr. Inv.	-31.8
Japan Smaller Companies	-10.2	Frontier MicroCap	-26.1

INTEREST RATES

KEY RATES	JULY 26	WEEK AGO
Money Market Funds	4.78%	4.75%
90-Day Treasury Bills	5.10	5.11
2-Year Treasury Notes	5.07	5.10
10-Year Treasury Notes	5.03	5.05
30-Year Treasury Bonds	5.10	5.10
30-Year Fixed Mortgage †	6.54	6.71

†BanxQuo

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR
General Obligations	4.10%	
Taxable Equivalent	5.86	
Insured Revenue Bonds	4.17	
Taxable Equivalent	5.96	

THE WEEK AHEAD

VEHICLE SALES *Tuesday, Aug. 1* » July sales of light vehicles most likely accelerated to an annual rate of 17.5 million units, according to WardsAuto.com. June sales stood at a pace of 16.2 million vehicles.

PERSONAL INCOME *Tuesday, Aug. 1, 8:30 a.m. EDT* » June personal income is forecast to have risen 0.6%, following a gain of 0.4% in May. That's the median forecast of of economists surveyed by Action Economics. Consumer spending probably increased by 0.4% for a second straight month.

PURCHASING MANAGERS' INDEX *Tuesday, Aug. 1, 10 a.m. EDT* » The Institute for Supply Management's July factory activity index probably stayed fairly steady at 53.9%, up from 53.8% in June.

CONSTRUCTION SPENDING *Tuesday, Aug. 1, 10 a.m. EDT* » Building outlays in June very likely bounced back by 0.3%, after a 0.4% decline in May.

FACTORY INVENTORIES *Thursday, Aug. 3, 10 a.m. EDT* » Manufacturing inventories probably rose 0.4% in June, after holding steady in May.

EMPLOYMENT *Friday, Aug. 4, 8:30 a.m. EDT* » Nonfarm payrolls are expected to have risen by 146,000 workers in July, after a disappointing gain of 121,000 jobs in June. The jobless rate probably held at 4.6%, while hourly earnings most likely increased by 0.3%.

The *BusinessWeek* productior improved to 284.1 for the ended July 15, a 12.7% gain year ago. Before calculation four-week moving average, th fell to 285.7.

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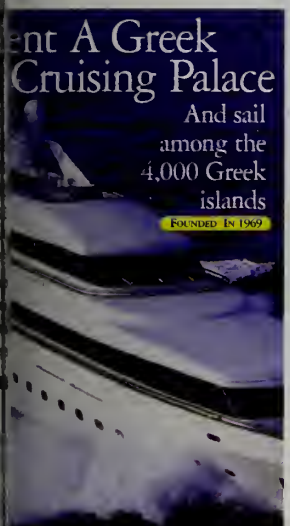

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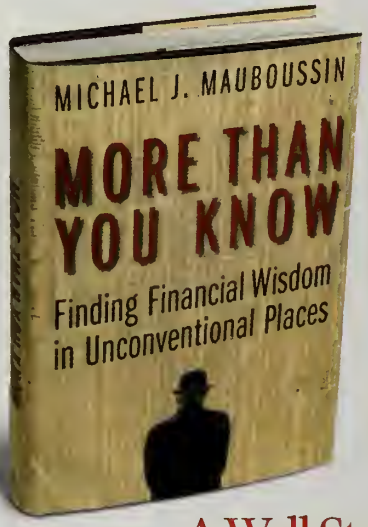
Swimming with Guppies

MORE THAN YOU KNOW Finding Financial Wisdom in Unconventional Places
By Michael J. Mauboussin; Columbia University; 268pp; $27.95

What does the development of human neural networks have to do with investing and markets? Everything, according to author Michael J. Mauboussin. Between birth and one's third birthday, it seems, our brains experience a huge growth in the number of synapses, or connections between neurons, followed by a pruning of the less useful links. This synaptic selection is an evolutionary winnowing that helps the individual in the struggle for survival. To Mauboussin, though, the messy and seemingly wasteful process has additional meaning: It's similar to what happens when a new industry emerges. Capital flows to the promising field despite uncertain returns. Lots of new companies are funded, and different business models are tried. Then as failed ideas are pruned, the number of companies falls. The parallels are so strong that a study of neural development yields valuable lessons for investors, says Mauboussin.



Mauboussin's *More Than You Know: Finding Financial Wisdom in Unconventional Places* draws investing insights from a wide range of scholarly disciplines, from cognitive science to fractal mathematics. It's also a fun read. The intellectually omnivorous author is chief investment strategist at Legg Mason Capital Management and an adjunct professor at Columbia Business School. He illustrates often abstract concepts, from the difference between risk and uncertainty to the distinction between individual and collective decisions, by drawing upon a diverse set of characters, from gambling legend Puggy Pearson to golfer Tiger Woods. "You will be a better investor, executive, parent, friend—*person*—if you approach problems from a multidisciplinary perspective," says Mauboussin. "It's the difference between moving into a fixer-upper home with a full set of power tools versus a simple screwdriver." The book's key shortcoming is that its brief essay chapters allow too little discussion of complex matters.

To be sure, in some cases the author's multidisciplinary approach is little more than a clever way to grab readers' attention. Take the chapter on "Guppy Love." Mauboussin describes biologist Lee Dugatkin's research into how female guppies choose their mates. It seems they have a thing for bright orange males. But when Dugatkin arranged for some females to watch other females pick dull-colored mates, all of a sudden dull became hot. Mauboussin offers this as helpful in thinking about human behavior, notably in the financi markets, where imitation is also widely practiced. There, when there is too much imitation or positive feedback, th herd takes over, a bubble is formed, and a crash isn't long coming. In this case, the scientific example does little mo than reinforce what history and experience have taught generations of investors. Still, Mauboussin gets to write: "Next time you buy or sell a stock, think of the guppies."

More Than You Know consists of four parts: investmen philosophy, the psychology of investing, innovation and competitive strategy, and science and complexity theory. first of these offers a sophisticated yet understandable discussion of probability and investm choices. In his investment-psycholog section, Mauboussin shows that, desp the current vogue for behavioral economics, there can still be fresh insights, as with his probe of "hindsi bias." And any investor eager for som guidance on how (and how not) to in in an economy that values innovatior creativity should read the book's thir section. It isn't easy to make money o creative destruction. Finally, the auth fourth segment looks into the collecti wisdom of markets. Mauboussin's id on this topic were the inspiration for *New Yorker* staff writer James Surowi popular book, *The Wisdom of Crowds*.

A Wall Street whiz sees lessons in everything from fish to fractal math

I must admit that I cracked open *M Than You Know* with suspi since it's a compilation of essays written for a Credit Suisse newsletter as far ba 2000. Often, such collectio are full of odd, dated passi But that's not so here. The insights sparkle, and the p have been revised and upd Moreover, the book is idea busy people: The author i you to start anywhere, eve the back, so you can read i profitably in small doses.

Still, there were times I would have liked more elabor as in a discussion of probability and stocks' "expected v And I'm still puzzling over some ideas, like power law distributions. But maybe I just need to do further readi can hear Mauboussin, an advocate of the passionate pu of ideas, reciting to me the lines he quotes from Dr. Seu

The more that you read, the more things you will know. The more that you learn, the more places you'll go. ■

–By Christopher

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2	**FREAKONOMICS** Steven D. Levitt, Stephen J. Dubner (Morrow • $25.95) *Crack gangs, the Ku Klux Klan, and more, examined by a University of Chicago economist.*	2	15
3	**BLINK** Malcolm Gladwell (Little, Brown • $25.95) *Snap judgments deserve careful consideration, says a writer for* The New Yorker.	3	18
4	**JIM CRAMER'S REAL MONEY** James J. Cramer (Simon & Schuster • $26) *Trading tips from CNBC's wild man.*	6	15
5	**THE LITTLE RED BOOK OF SELLING** Jeffrey Gitomer (Bard Press • $19.95) *Why people buy.*	4	22
6	**SECRETS OF THE MILLIONAIRE MIND** T. Harv Eker (HarperBusiness • $19.95) *Shape your financial destiny.*	7	15
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11	**THE FRED FACTOR** Mark Sanborn (Currency/Doubleday • $14.95) *Bringing creativity to your work and life, just like this mailman does.*	9	17
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14	**SUCCEED ON YOUR OWN TERMS** Herb Greenberg, Patrick Sweeney (McGraw-Hill • $21.95) *Profiles of successful folks—and a personality test for yourself.*	—	1
15	**THE ONE MINUTE MANAGER** Kenneth Blanchard, PhD, Spencer Johnson, M.D. (Morrow • $19.95) *Three management techniques conveyed in brief story form.*	14	14

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4	**RICH WOMAN** Kim Kiyosaki (Rich Press • $18.95) *How women can take control of their finances.*	9
5	**THE AUTOMATIC MILLIONAIRE** David Bach (Broadway • $12.95) *Put your investment program on autopilot.*	2
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11	**THE INTELLIGENT INVESTOR, REVISED EDITION** Benjamin Graham, with Jason Zweig (HarperBusiness • $19.95) *The classic treatise on "value investing."*	12
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IdeasFaceTime
WITH MARIA BARTIROMO

Wilbur Ross Thinks Bigger

IF YOU HAVE ever been to a yard sale, spied a dusty artifact with a "$1 or best offer" tag on it, recognized its value, plunked down a buck, and then sold it on eBay for 100 times that, you have a small idea of what it's like to be Wilbur Ross. The 68-year-old billionaire bottom-fisher on July 23 agreed to sell his private-equity vehicle, WL Ross & Co., to Amvescap for some $375 million. Shortly after the deal—the first significant combination of a conventional money manager with a private-equity investor—was announced, I talked with Ross.

Why do this deal now? And what does it say about the state of capital markets when a $3.5 billion buyout fund is too small to compete?
As you know, we have been very active in a number of countries, pushing into China, India, and Vietnam. Amvescap has a particularly strong presence in China. Second, we are entering an era of megadeals. It used to be that a few billion made you a large [private-equity] fund. Now it's 10 or 15 or 20 billion dollars before you are a large fund. Five years ago you would have been put in an insane asylum if you said there would be a private-equity deal of the magnitude of the HCA deal. I wouldn't say we are too small, but we want to be able to ramp up scale quite a bit in the future.

Some might say you're cashing out. And they'd want to know what you see that others don't.
Well, this plan is over five years. And I have no intention of retiring even at the end of the five years. It's not so much cashing out as it is giving the firm we started six years ago a permanent life and setting the stage for an eventual succession.

The Amvescap deal will dramatically increase your resources. How will you put that money to work?
We have $3.5 billion, and they have $2.3 billion...the areas that we are going into most heavily are textiles, automotive parts, and reinsurar are looking at the reinsurance of reinsurance companies though it's likely that the frequency and severity of big will be greater than they have been in prior years, the ir in premiums more than offsets the risk. It's a bit of a dep from our normal industrial business.

Last time we spoke you said you are looking for acquisitio China and India in the low-tech sectors. Why these areas?
The most powerful economic force in the world today i alization, and globalization mainly means one thing: standards of living in the developing world and com consumption. More clothing, more energy, more tran tion. The stats are amazing. In India, there are 6 cars pe people of driving age. There are 8 per 1,000 in China. In ica, it's 750 cars per 1,000. In other important areas sumption, there are the same staggering ratios. W trigues me about China is that the numbers are s

What might take the punch bowl away?
The only [threat] specific to private equity is irr behavior of an extreme scale—people payin multiples. But these [private-equity] people– Kravis, Steve Schwartzman, David Bonderman– wild men. So there's not much danger of that.

You describe the deal with Amvescap as milestone.
It's a sign of the coming of age of dustry. We will see more deals of t and we will see some firms doing

Does the deal reflect a peak in th business?
Time will tell. But I don't thinl essarily does. A lot of firms think about succession. This de inates the necessity for our ne management to raise a bundle to buy out my stake. I have a b out, so that takes care of me. T plenty of people running these their 60s, and at some point there h a transition to the next generation. someone might think he is a mast universe, he is mortal.

Maria Bartiromo is the host of CN Closing Bell.

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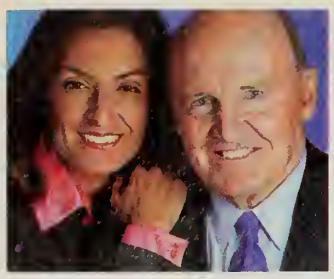

Ideas The Welch Way

BY JACK AND SUZY WELCH

Battle Stations in a Dead Calm

How should a traditional company—with rigid processes and long-term employees—change in order to compete with the fast-moving global competitors popping up everywhere?
–Paulo Miguel, São Paulo

First, we're going to make an assumption: Your company is not under siege from global competitors quite yet. You're way too calm.

That's O.K. for now. But get ready. Because "war" hasn't officially broken out yet, your job will be more difficult than it would be if your company was being attacked. Organizational transformations, especially the brave-new-world kind required by global competition, almost never happen unless people really feel the fear factor in their bones. Survival is a mighty motivator.

Without an impending crisis, oh, how people love the status quo! A bureaucracy like yours, in fact, can feel like a warm bath. People never want to get out. And they certainly have no desire to jump into the icy water of global competition. And icy it will be, at least at first, because competitive organizations must be flat, fast, and transparent. Informal, candid communication is a must. So, too, is a mindset that has people constantly seeking best practices inside and outside the company.

How to motivate a complacent bureaucracy without a clear and present danger

And since people won't jump, they need a push. Which is why you, or any leader trying to galvanize change, has to present a powerful case. And make it personal. Your people will change when, and only when, they see how new behaviors will improve the company and, more important, their own lives.

So get gritty and detailed. Use as much data as you can gather on industry dynamics, profit margins, emerging technologies, political trends, whatever will best illustrate two vivid story lines: one about what the company will become if it doesn't change and the other about what happens if it does. Contrast plant closings with growth opportunities at home and abroad, lost jobs with more interesting work, and flat or shrinking wages with more money for everyone.

Then start campaigning. Talk and talk and talk. Not believing or absorbing a tough message the first or second time around is just human nature. You will have to repeat your case to the point of gagging, and then repeat it agai

Eventually, however, if your case is compelling enough behaviors will change. They will change faster if you pub praise and celebrate them whenever they occur, and fast still if you reward the people who demonstrate them.

Speaking of people, two other actions will help your transformation effort. First, make sure you start to hire a promote only true believers, those who completely accep case for change and will proselytize for it, too. Second, m sure you start to ease out resisters who can't let go of the old days, no matter how much persuading they hear. Yes some of them may do their jobs well, but they should be working someplace else. Probably at one of the few companies left out there with no global competition.

I have achieved a lot as a leader and still want to grow and on to more challenging positions. However, I fail to make a impact at interviews. I always think I am right for the job, t right answers don't come to me until it's over. Your advice?
–Eddie Khumalo, Johanne

Your question reminds us of the time one of us was part hiring process where a highly qualified young job candi strutted into the room and started his interview with th words: "So let me get this straight. Do you ask me ques or do I ask you?" His bravado, needless to say, did not e win over any hearts.

You don't have a bravado problem—quite the opposit it sounds as if you're not winning over any hearts, eithe would guess that's because you're too tied up trying to v over brains with perfectly crafted answers.

That's off track. Your résumé should speak for your credentials. Of course, you can use the interview to elab or fill in any blanks on your expertise. But based on you question, it seems more important that you show your potential boss who you really are. That is, a leader who about your work and your team passionately. A colleag can laugh, listen, and worry. A real person with outside interests and friends, maturity and self-awareness, and ability to connect emotionally.

Indeed, in any interview, your best selling point can your authenticity. So stop performing, and be yourself. positive impact you long for is probably right inside yo only you'll let it out.

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(P.48)

BEHIND THE PFIZER SHAKEUP

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How This Kid Made $60 Million In 18 Months

Digg.com's **KEVIN ROSE** leads a new brat pack of Silicon Valley entrepreneurs.

BY SARAH LACY AND JESSI HEMPEL (P. 40)

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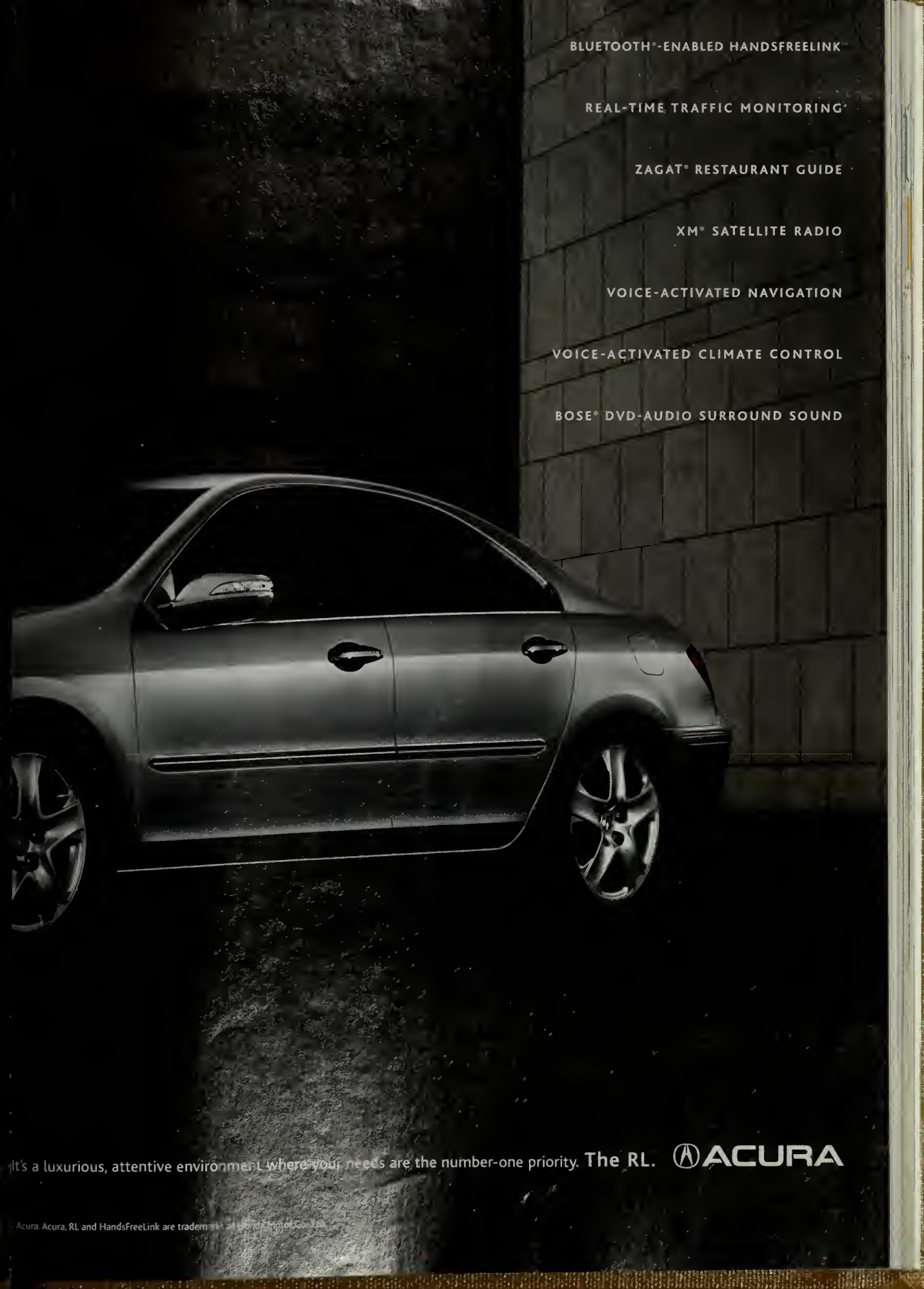
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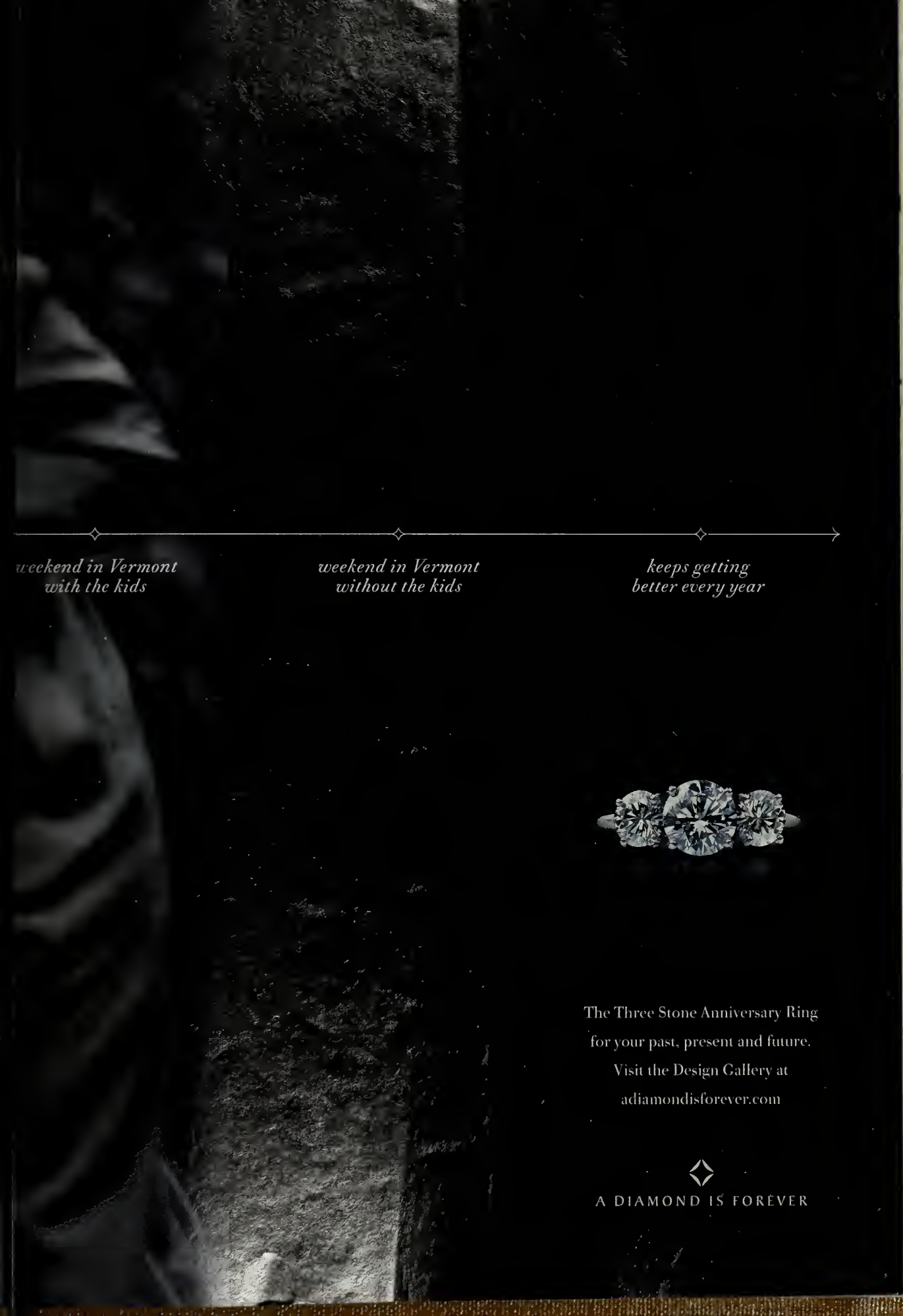

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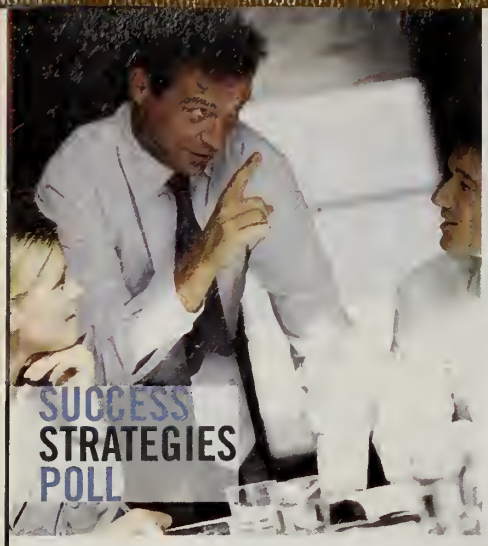

Previously we asked you:

MY COMPANY ENCOURAGES TEAMWORK ACROSS DEPARTMENTS.

Strongly Agree 26%

Agree 47%

Undecided 0%

Disagree 21%

Strongly Disagree 5%

Results as of 7/27/06.

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Tell us your answer at:
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UP Front

"We aspire to do more than stay out of trouble."

–Boeing CEO Jim McNerney, trying to assure the Senate Armed Services Committee that the company's ethical failures have been corrected, as reported by the Seattle Post-Intelligencer

ED BY DEBORAH STEAD

WIND

OSS OMESTIC OGRESS

RNMENT STATISTICS have
l to track America's
vledge-based economy,
nessWeek argued earlier
ear (BW—Feb. 13), in a
r story that
pted a flurry
action inside
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ington is
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ember, the
au of Economic
ysis, which issues gross
estic product estimates,
cts to release a
minary version of what
ls "satellite" accounts
esearch and
lopment. The BEA,
ever, is not yet ready to
the leap of
rporating the new R&D
investment figures into the headline GDP number.

Meanwhile, the **Commerce Dept.,** which houses the BEA, is about to announce the creation of a panel of academicians and business leaders who will propose metrics for innovation that go beyond R&D. Of particular interest will be measuring innovation in non-high-tech sectors like retailing, where improvements in supply-chain management have helped drive huge productivity gains in recent years. "The more we can understand how innovation affects productivity and economic growth, the better off we will be," Commerce Secretary Carlos M. Gutierrez told *BusinessWeek*. The committee's interim report is expected early next year, its final report by midyear.

–Michael Mandel

E BIG PICTURE

LY 9% of top executives at U.S.
ltinationals say America has gained a
npetitive edge over the past five years.
re's where they see gains and losses.

% WHO SAY U.S. LOST GROUND IN...	
rker health-care l pension costs	65%
rnative energy rces	38%
ilability of led workers	35%

% WHO SAY U.S. MOVED AHEAD IN...	
Business ethics and corporate governance	63%
Employee productivity	50%
Innovation	36%

ricewaterhouseCoopers' Management Barometer survey of 131 CFOs and managing dire

STREET SIGNS

Inflation: The Rolex Effect

INFLATION FEARS have driven long-term interest rates a full percentage point higher over the past year, even though inflation seems to be under control. Why does Wall Street see the specter of rising prices everywhere? Maybe because the well-heeled portfolio managers who set the rates by buying and selling bonds face more inflation than the rest of us do.

Yes, sad to say, the cost of being pampered is going up fast, says David A. Rosenberg, chief North American economist of **Merrill Lynch,** who has mischievously created a "Wall Street core consumer price index" to measure just how fast those prices are rising. His index shows that gardening and lawn care services are up 7.7% over the past year; private school tuition and airline fares, up 5.9%; watches and jewelry, 4.7%. Overall, his Wall Street core CPI is up 4% through June, vs. 2.6% for the official core CPI. Rosenberg says his home-brewed index is meant to be "totally tongue in cheek." But he believes there's a kernel of truth to the theory that the rising costs of living the good life may be clouding portfolio managers' judgment. When he calls on these clients, he says, "all I hear is that the steak tartare is up blank percent over here, and the martini is up blank percent over there."

–Peter Coy

UPFront

GEARING DOWN

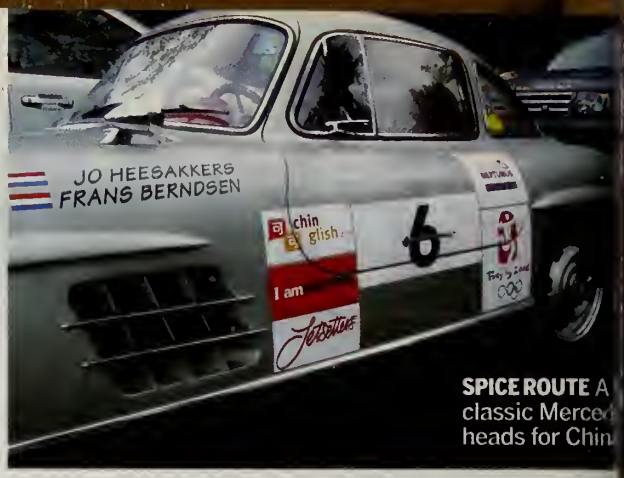
IS JOB ONE GOING TO BE AN ASSET SALE?

HOW MUCH would **Ford** be worth broken up—or at least slimmed down? The carmaker, which just restated its second-quarter loss to $254 million from $121 million, may be about to find out. It has just hired former **Goldman Sachs** M&A banker Kenneth Leet to advise it about possible alliances with other automakers and about the possibility, too, of selling some assets: its **Jaguar, Land Rover, Aston Martin,** or **Volvo** brands, or its one-third stake in **Mazda** or a chunk of **Ford Credit.**

At the close of trading on Wednesday, Ford's market cap stood at about $13 billion, roughly 7% of **Toyota's** (and half of **Starbuck's**). Volvo is probably worth at least $7 billion, a smidgen over what Ford paid for it in 1999. And its share of Mazda is worth about $3 billion. The value of those two brands alone, in other words, equals about 75% of Ford's market cap.

Then there's Ford Credit. A half-stake in the financing unit could be worth about $6 billion. Critics say the carmaker is spread across too many struggling brands. (Ford says Volvo and its British brands will lose money this year.) It should pare back, they say, ditching **Mercury** and the British brands, and invest in shoring up Ford, **Lincoln,** and Volvo. Could Ford get along with only these three? Toyota has just **Lexus** and **Scion** in addition to its flagship brand and is leaving Ford in its rear-view mirror.

–David Kiley



SPICE ROUTE A classic Merce heads for Chin

SILK ROAD RALLY

A CARAVAN of 84 vintage cars—from Alfa Romeos to Bentleys to Mercedes, all emblazoned with sponsors' logos—is snakin through 14 countries as it travels from the Netherlands to China, where it is due to arriv on Aug. 11. The 10,874-mile Amsterdam-Beiji Rally, broadcast daily by China's leading spo channel, CCTV-5, is the brainchild of Jan Vermeer, a retired Dutch entrepreneur in Hor Kong. The idea is to retrace part of the histori Silk Road, which allowed the West to trade w China. The rally's sponsors include the Dutch owned Chinglish.com, a Web site launching t fall that will offer instant e-mail translations (with audio pronunciation tips) between Eng and Mandarin. *–Aili McConn*

TRENDSPOTTING

DISASTER MASTERS

» **DEMAND IS UP** for chief continuity officers, according to executive search firm **Christian & Timbers.** In the past nine months, C&T has initiated a half-dozen hunts for CCOs, who ensure disaster readiness—"a sizable increase" from before, says Peter Metzger, head of C&T's Global Security & Risk Management practice.

He credits today's use of global supply chains and crises ranging from data theft and hurricanes to war. Financial companies have long had CCOs (also called chief security officers). Now media, energy, and consumer companies are hiring them as the job expands beyond securing IT systems, moving some CCOs into the C-suite. *–Elizabeth Woyke*

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rachel.tong@dtz.com.hk

Stephen CH Shan
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Global Sole Agent:
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UPFront

ON BROADWAY

THE JUKEBOX MUSICAL PLAYS ON

As *Jersey Boys*, the Tony Award-winning play about Frankie Valli, continues its Broadway run and tickets go on sale for Twyla Tharp's Bob Dylan musical, *The Times They Are A-Changin'*, another jukebox show is already in the works: *Natural Woman*, featuring the songs of Carole King and co-writer Gerry Goffin. It will be the latest in a long string of musicals using songs from publishers' back catalogs—from box-office hits like *Mamma Mia!* (based on ABBA songs) to flops like the recent Elvis-based *All Shook Up* and *Lennon*. (King's back catalog is owned by **EMI.**)

Why so many pop-classic productions? "As CD sales continue to decline, publishers are actively looking for alternative sources of revenue for their clients," says music industry attorney Mark Levinsohn. Selling song rights to Broadway is a way to squeeze revenue out of back-lists. Beyond royalties, the publishers pick up cash from sales of CDs (of original music and of cast recordings of the show). The songbook musicals, says Glenn Peoples, founder of music industry blog Coolfer.com, are part of a "repurposing" strategy that includes licensing songs for compilation CDs sold at **Starbucks** and **Pottery Barn.** *–Paula Lehman*

OFF BALANCE

THE NEW WAL-MART *By Bruce McCall*

...Wal-Mart hopes to prove it can reach affluent consumers... *–AP, Mar. 22, 2006*

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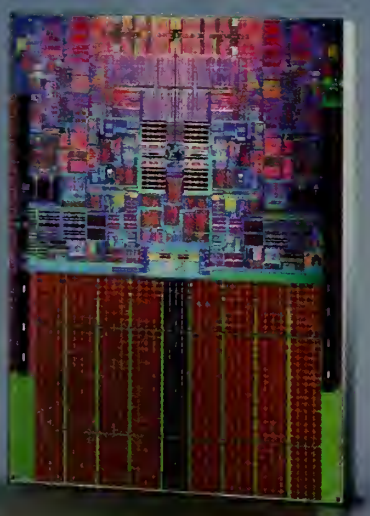

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Our Top Young Talent

EVERY TEAM in Major League Baseball has a farm system to nurture young talent. At *BusinessWeek*, our farm team is our internship program. Over the years dozens of eager college and grad students have summered with us to learn the craft of business journalism. A few have stayed on, bringing raw talent and a fresh perspective to our world. Distinguished former interns from the Class of 2005 include Elizabeth Woyke, a reporter for our UpFront section, and Lindsey Gerdes of our B-school team.

This summer we have our biggest group of interns ever. Fifteen are working in our New York office, dispersed throughout the magazine and BusinessWeek Online. Our London bureau has two, and our San Mateo (Calif.) and Paris bureaus host one each. Several are undergrads who will be returning to schools such as Yale, Saint Mary's College, and the University of Nebraska. Two are journalism undergrads at Northwestern, one is getting a master's in journalism at New York University, and three are recent or soon-to-be Columbia J-school grads.

In their short time here, our interns have written regularly for UpFront and Executive Life's Plus page, they've worked on our massive B-school and philanthropy projects, and they've done stories and slide shows for businessweek.com. Art intern Byron Regej, an Aussie studying at the Sch of Visual Arts in New York, redesign our Feedback section. And did you s our July 10 "How failure breeds suc cover with the picture of a man and flying machine? Credit for that art concept goes to John DeBruicker, a senior at Colby College.

As this summer's program nears end, we'd like to thank all of our int for a job well done.

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REMENT: DIFFERENT SPECTIVES AND USEFUL TOOLS

I ready to retire?" (Retirement Guide, 24) offered excellent resources for pping for retirement." However, for dparents raising grandchildren, "fo- ıg your mind on the future" requires nificantly different perspective. U.S. us 2000 figures show that 2.4 mil- grandparents are singlehandedly ng more than 6 million grandchil- . The number of grandparents na- vide who are caring for grandchil- at a time of life when they expected e doing something else is growing ficantly and affects every income lev- om executives to clerical staff. While xperience brings much joy to care- s, it also brings challenges such as fi- ial hurdles, conflicts with retirement s, and dealing with children's emo- l issues.

festyle planning as well as financial ning for retirement-age adults with lren to raise is crucial. We need help!

–Terry Casdorph
Anchorage, Alaska

IREMENT WAS ONE of the less bril- solutions to U.S. unemployment ng the Great Depression. Where has it demonstrated that limiting the cre- ı of value is good for any person or so- ? Isn't retirement a function of con- ption? How does the switch from ing value to consuming value produce benefit to the participants or society? you aren't happy with the work re doing, why not go now to where talents will be rewarded? Wait for reason, and it may be too late.

–Gene Youngreen
Roseville, Calif.

CAREER COUNSELOR, I am happy e transition-to-retirement issues in- ed in planning guides along with fi- ial advice. I have been using Turning ts Navigator for more than a year and it a very effective tool. In the article, was given a "mixed review" because so thorough and takes time to com- e. To my mind, this is akin to entering rge bookstore and complaining that number of books creates an over- lming choice. I utilize Turning Points igator specifically because it requires a er level of thought than tools that ply ask multiple-choice questions and spit out recommendations.

–Lisa Severy
Director of Career Services
University of Colorado
Boulder, Colo.

> "For grandparents raising grandchildren... lifestyle planning as well as financial planning... is crucial. We need help!"
>
> *–Terry Casdorph*
> *Anchorage, Alaska*

MORE AND MORE EMPLOYERS are hiring retirees for part-time jobs and for temporary or project assignments. Many new Web sites help employers reach older workers who are interested in continuing to work and do not charge seniors to post a résumé or search for a position. These include: RetiredBrains.com, RetirementJobs.com, yourencore.com, RetireeCareers.com, and seniors4hire.org.

–Arthur Koff
Retired Brains
Chicago

SEEING CRACKS IN THE VA'S MEDICAL MODEL

WHILE "THE BEST medical care in the U.S." (Health, July 17) suggests that the Veterans Affairs system should be the model for the entire U.S., it fails to address the most important question: Can we afford to have the federal government own, operate, and employ all hospitals, clinics, doctors, and nurses?

The public has shown no appetite for a federally owned and operated health-care system. It has expressed a desire for the federal government to help make positive change. The VA system is helping to lead that change. An example is the VA's early implementation of electronic medical records—proof that this technology improves patient care and reduces costs. Following this example, President George W. Bush made it one of his priorities to develop electronic medical-record standards and procedures within 10 years.

–Sarah Berk
Executive Director, Health Care America
Washington

Editor's note: The writer's organization is a nonprofit advocacy group opposed to government-controlled health care.

CORRECTIONS & CLARIFICATIONS

"ConocoPhillips. Surging" (Inside Wall Street, July 31) should have said that Burlington Resources, not Burlington Northern, was acquired by ConocoPhillips.

MY LAST MILITARY position before retiring was colonel, commander of the health facility in Bamberg, Germany (with many prior years in private practice), serving a population of 13,000 military and dependents. I find current VA services in Las Vegas, as you described past VA care, "understaffed, underfunded, and uncaring." Try to change things, and you'll find the hierarchy hiding and unresponsive.

Some 16% of Nevada's population are veterans requiring medical and specialty referral services. We have no hospital, with only a promise of one many years from now. Our current medical needs are served by small clinics. As a physician I find evidence of substandard care—from the primary-care doctor who accepts a new patient without doing a complete physical to the treatment of glaucoma (diagnosed by a student and an optometrist) without a referral to an ophthalmologist.

A drastic makeover is needed. There should be fewer older, retired doctors as primary-care physicians, to be replaced by newly graduated MDs being trained with government funds as a fulfillment of their obligation. And every veteran should be referred to a specialist when indicated.

–Colonel S.J. Hazan
U.S. Marine Corps (ret.)
Las Vegas

How to reach *BusinessWeek*

LETTERS FOR READERS REPORT

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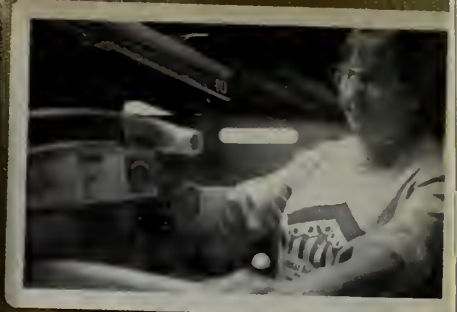
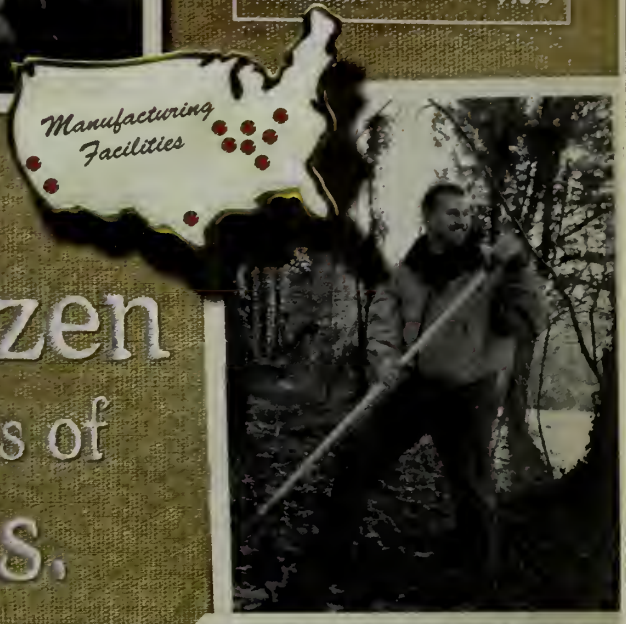
*2005 Center for Automotive Research study. Includes [illegible] and supplier employees, and jobs created through their spending.
**Toyota vehicles and components are built using [illegible] U.S. [illegible] parts. ©2006



Toyota U.S. Operations	
Plants	10
Jobs	386,000*
Investment	$13B



Being a good corporate citizen starts with hiring lots of good citizens.

WHAT'S A GOOD CORPORATE CITIZEN? It's not about awards or mission statements or press releases. It's about people. People who care about what they do and how they do it. And at Toyota, we know these people pretty well, because we hire them every chance we get.

You see it in every vehicle we build here.** Our over 32,000 team members take pride in everything they do. Quality, teamwork and dependability, that's what they are all about.

Our team members care about doing what's right; at work as well as in their local communities. They really are good citizens. Which in turn makes Toyota a better corporate citizen. Isn't it nice when things work out?

TOYOTA

toyota.com/usa

Tech&You

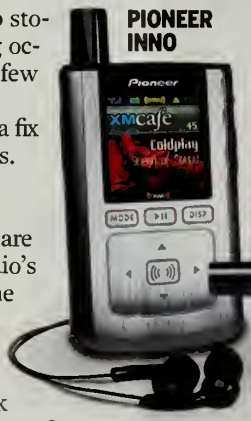
BY CLIFF EDWARDS

Taking XM Out for a Stroll

Walking through the streets of New York recently, I tuned out the cacophony of honking horns and other big-city noises and listened to the soothing sounds of KT Tunstall, Good Charlotte, and other artists on XM Satellite Radio's Hitlist channel. Descending into the subway, I settled ba with some MP3 dance tunes I had ripped to the same device earlier. Back

in the office, I caught up on the day's top stories with the BBC World Service, glancing occasionally at the screen to keep track of a few stocks I've been watching.

Not too long ago getting my day's media fix would have required carrying three devices. Now, with two new pocket-size satellite players—the Pioneer Inno and Samsung Helix—life has gotten a little easier. These are the latest players built on XM Satellite Radio's XM2go platform, and they're essentially the same device, save for a few cosmetic differences. Pioneer opted for a more industrial feel, with brushed metal and black accents; Samsung chose glossy black with silver accents. Each model crams a slew of useful functions into one 4.5-ounce device with a bright 1.7-inch color screen.



PIONEER INNO

SAMSUNG HELIX

These new players can set you on a voyage of discovery, and rediscovery. For $399 and a $13 monthly subscription, you can troll through 170 live channels of the satellite provider's programming, enjoying a blast from the past with an old Doors tune or keeping up with the latest hit from the Pussycat Dolls—often delivered with CD-quality sound. Built-in memory lets you transfer to each device a few CDs' worth of your own MP3s or Windows-encoded music, or you can record up to 50 hours of XM content.

BOTH RADIOS ALSO HAVE A NIFTY FEATURE called TuneSelect, which sounds an alert if a favorite song or artist is playing on another channel. Even better, XM's tie-in with the online music service Napster lets you mark songs you like with the press of one button, and then buy them the next time you sync the player with software on your PC. Once you learn the options, you never run out of something new to listen to.

The best thing about the Inno and Helix is the powerful built-in radio, which, unlike previous generations of portable satellite devices, can grab programming even deep inside some buildings. But it's not quite time to dump your iPod. For one thing, battery life ran just a little over three hours on both devices in my tests. If you're just listening to recorded content, you can count on about 10 hours. That's less than the iPod, and only a fraction of the battery life promised by oth MP3 players on the market.

Unlike the iPod, XM2go players are an exercise in cord management. At home, you plug the radios into a dock tha has long cords for power, and connect to your stereo for bett sound. A $69 car kit comes wi what seems like another 50 fe of cords. No matter what I did the cords quickly tangled.

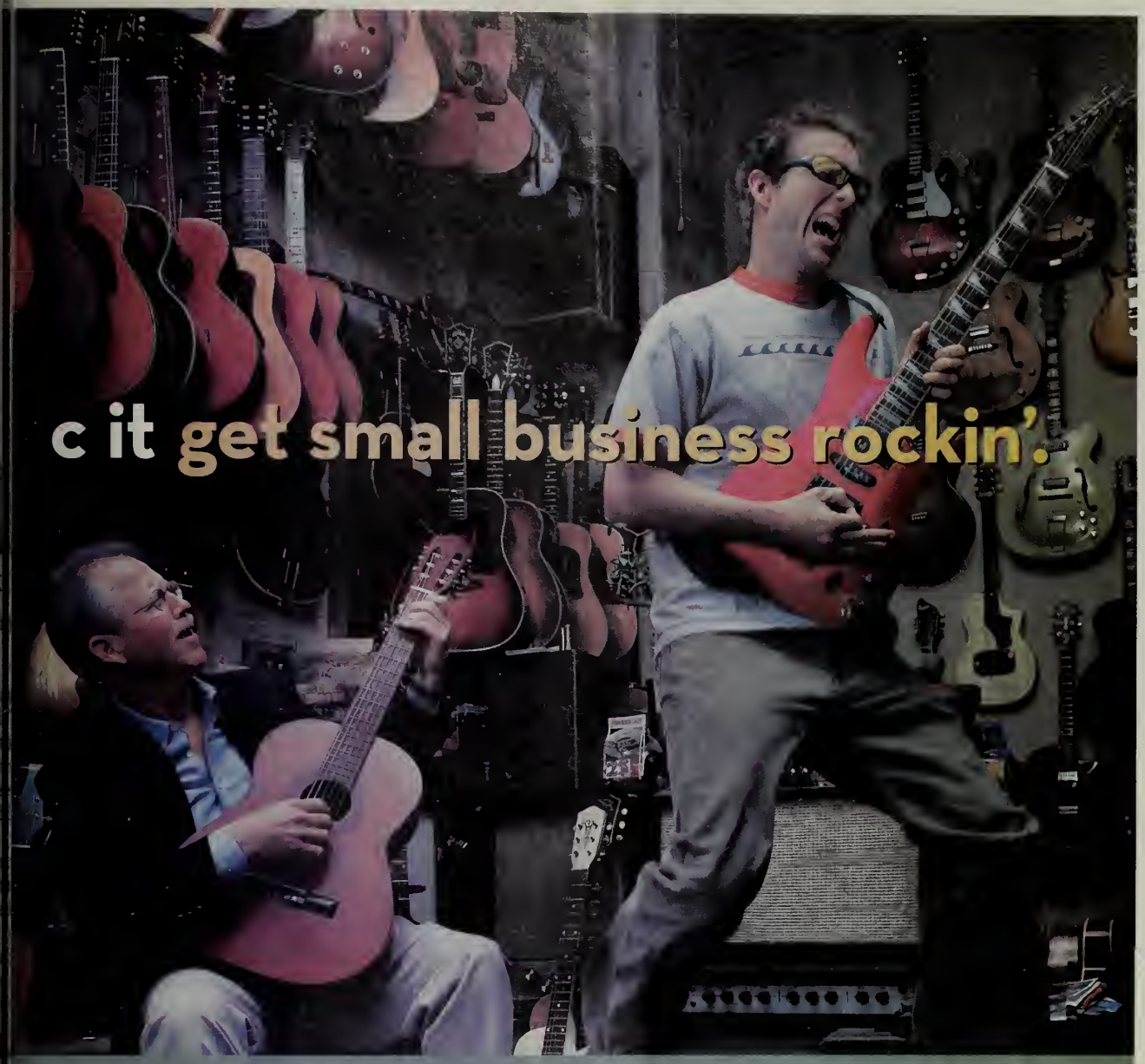
I also found the menu syste less user-friendly than that of t iPod and other players. In orde save space, the manufacturers have assigned multiple functio to each button. These are deter mined by the order in which y press the buttons. And both models dock on their sides, ma the sequences doubly confusin

Another problem: The featu you get today may not be avail in the future. The music indus is suing XM because the radio you record satellite content an mix it with your own digital music. They argue that this remixing of song tracks is the equivalent of piracy, though a royalty fee is included in the subscription charges.

New iPod challengers: Two pocket-size satellite radio players

Even with all these concerns and annoyances, I've foun myself craving the company of these XM2go devices more and more. Maybe they don't provide a simple way to subscribe to podcasts, on the model of Apple and iTunes, a maybe you can't hear Howard Stern, who's only on Sirius Radio. Still, you get excellent audio quality, access to sport and talk radio, and the ability to add in your own music. T makes these radios worthy competitors in my book.

BusinessWeek online Steve Wildstrom is on vacation. For past columns and online-only reviews, go to Tech & You at businessweek.com/go/techmaven/ To hear Steve Wildstrom's podcasts go to www.businessweek.com/search/podcasting.htm



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MediaCentric

BY JON FINE

Growing Up is Hard to Do

This summer MTV turned 25. Coincidentally, 2006 looks like the year cabl TV grew up. This is good in human terms, more or less, but in media term it's not. "Growing up" in this case means "maturing," which implies age. stagnation, and settling down to earthbound growth rates. This year cabl networks' total ad revenues will rise 6%, says Aryeh Bourkoff, an analyst

with UBS Warburg, which has worked with key cable companies recently. This is a nice increase but only about half of last year's 11% gain. Add in the fact that this year's upfronts—sales of future cable ads—are slow, and you might start to understand why the stocks of companies owning cable channels have been whacked. For these and other reasons, Viacom, with its stock down around 20% since December, has been paddled the most soundly. As a company, "it's doing O.K.," says Pali Research analyst Richard Greenfield, "but it's being valued as if it's in rapid decline." Even E.W. Scripps Co., owner of still high-flying cable networks Food Network and HGTV, has watched its stock sink 15% in the past year. Grown-up, remember, is a synonym for uncool.

ALL THAT SAID, the situation doesn't quite make sense. A media universe moving toward a state of infinite niche would appear to favor cable TV, which finely slices demographically coherent audiences and serves up the kind of programming for which advertisers pay a premium. The broad metrics for the industry are not tanking. The "broadcastization" of cable—that is, the gradual decline of audience share that has afflicted the big TV networks—has not arrived. The percentage of households tuning into cable continued to rise, if slightly, through the first quarter of 2006, the latest period for which figures are available, according to Nielsen Media Research. Other indicators also show strength. In late July, Scripps, which last year derived more than 35% of its revenues from cable, announced that overall cable revenues rose 17% in the second quarter of this year and that it expects ad dollars to increase 13% to 15% in the third quarter.

But there's angst in the air. The laggard upfronts worry onlookers. (It would be ironic should cable's upfronts end lower this year while overall audience share grows. It was just the opposite for broadcast, whose upfronts thrived for years even as its share sank.) A Wall Street accustomed to double-digit ad growth isn't happy when gains slow to single digits, even if cable still beats overall ad trends. Rino Scanzoni, chief investment officer at media buying age mediaedge:cia, concedes that cable is ' victim of its own success." Most client he says, have already redirected broad dollars toward cable. "You run into a situation where you've kind of maxed your investment" in the medium.

And a world of infinite niche spawns infinite competition. The Web has a har time manufacturing massive mainstrea hits, but it can churn out niche all day l If 2005 was the year of MySpace, 2006 the year of YouTube and its Web-video brethren. In them, some see threats to cable, even if YouTu manifold charms do not yet include a business model.

Cable growth is slowing just a bit, but angst is in the air

Nor can cable leverage broadcast TV's ace in the hol "Broadcast is program-drive says Jack Kodesh, national broadcast supervisor for age Media Planning Group. "Cab is network-driven." Broadca biggest successes are built o scarcity: Think of how expensive ads get on event shows the Oscars and season finales of *American Idol*. Cable's biggest hits can't command similar premiums. And the expanding nether reaches of your cable system—and no the Web as well—lead to more ad inventory and price pressures. This is why, says Bourkoff, the big cable playe can no longer drive up ad rates.

Cable still faces the fragmentation of a young medium, its slower growth leads to a perception that it's a mature Clearly, growing up these days is a complex business. You could hardly blame MTV if, like so many 25-year-olds, it's striving mightily to remain an adolescent. ■

BusinessWeek online For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia

JAMES C. COOPER

nvestors May Be Celebrating Too Soon

vised numbers show labor costs could keep the heat on inflation

U.S. ECONOMY When Washington reported that the economy's owth rate slowed to 2.5% in the second quarter, both stock and nd investors whooped and hollered. Their buying spurred rallies lecting the belief that the economy is slowing enough to ease lation pressures and forestall the need for more interest rate hikes

ıe Federal Reserve. Maybe they should look a little er into the report, especially at the implications of government's revisions covering all the data in the nal accounts over the past three years.

he picture that emerges is not as comforting as the investors thought they were looking at, especially regard to the inflation outlook. For the coming year, ıew data suggest the Fed's task of keeping prices lued will be more difficult than the earlier numbers implied.

's not just that the trend in inflation outside of energy food is now slightly higher than earlier data had vn. The revisions also indicate the economy might be e inflation-prone now than it was in the late 1990s. In icular, the new numbers imply that pressure on labor s from tight job markets are ready to play a more e role in pushing up inflation.

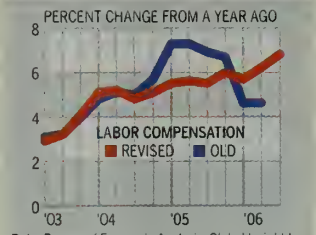
he Bureau of Economic Analysis (BEA) reported that ıomic growth during 2003 through 2005 is 0.3 entage points per year slower than first estimated, ed lower in large part by a big downward refiguring usiness investment, which means productivity growth so slower. More striking, revised data show an lerating growth trend in labor compensation, uding both wages and benefits, not a slowdown as in the previous data (chart).

r the Fed, these are unwelcome patterns. Until now, numbers demonstrated that strong productivity gains e almost wholly offsetting subdued growth in pensation, a mix good for keeping the wage/price al from cycling upward. The new data suggest enting such a spiral will be a much tougher task now. n all, these trends mean that even if the Fed chooses ke a break from rate hiking at its August and ember meetings, its work is not necessarily finished.

BEA'S REVISIONS place special attention on the eau of Labor Statistics' (BLS) upcoming report on luctivity and costs, due on Aug. 8. The report will ude the BEA's updated numbers on overall output and r compensation and will give a more accurate picture st how much productivity has slowed. More ortant, it will show how much pressure is building on unit labor costs, or compensation costs not offset by productivity gains. Unit labor costs tend to be tightly correlated with inflation trends.

The cost pressure could turn out to be substantial. We now know that, through the first quarter, labor income from wages and benefits grew 6.2% from a year ago, up from a yearly growth rate of 5.6% in the first quarter of 2005. That's a sharp reversal from the old data, which had shown a slowdown from 7.3% to 4.6%. Moreover, in the second quarter, over-the-year growth accelerated even more, to 6.8%, the fastest such clip in 5½ years.

A RADICALLY DIFFERENT VIEW OF PAY GROWTH



Data: Bureau of Economic Analysis, Global Insight Inc.

Through the first quarter, current BLS data show unit labor costs up a mere 0.3% from a year ago. However, back-of-the-envelope estimates by several economists, taking into account the expected slowdown in productivity, suggest that, through the second quarter, the BLS's new data will show unit labor costs rising about 2.5% to 3% over the past year. Depending on the mix of revisions, that could be the fastest pace in five years. Certainly the new trend will present a radically different picture than before, suggesting more intense pressure on companies either to lift prices to cover the added cost or to thin their profit margins.

INDEED, THE NEW DATA imply higher costs have resulted in faster inflation and lower profits than originally thought. Based on the government's economywide profits tally through the first quarter, the revised numbers show that earnings growth remained strong but not as robust as portrayed by the earlier data. Profits rose 18.9% from a year ago, instead of 28.5%, and margins, while still high, were lower than first measured.

Meanwhile, outside of energy and food, the price index for personal consumption expenditures—the Fed's

principal inflation gauge—rose at an annual rate of 2.9% from the first quarter, the largest quarterly pickup in 12 years. Measured from a year ago, the pace of core inflation through June stood at 2.4%, already close to the 2.5% top end of the Fed's forecast range for all of 2006.

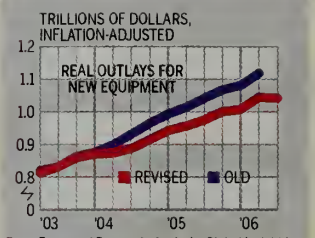
Additional pricing power might well be one of the reasons why profit growth continued to beat expectations in the second quarter. Through July 28, Thomson Financial says that, with 322 of the Standard & Poor's 500 companies having reported earnings, 69% have beat analysts' expectations, well above the typical 60% for a given quarter. If current expectations for the remaining 178 companies are met, Thomson says S&P 500 earnings would be up 14.8% from a year ago, far above the 10.9% gain expected at the start of the quarter. Even without the energy sector, profits would be up 11.4%.

THE POTENTIALLY DISTURBING question, especially for policymakers at the Fed, is this: Has a lack of business investment in recent years, along with a new lower trend in labor force participation, reduced the economy's noninflationary speed limit? That is, does the economy still have the same freedom to grow as rapidly as it has grown since the late 1990s without sparking inflation?

It was business investment, particularly in tech equipment, that helped to expand the economy's underlying growth rate of productivity, and thus to grow faster than it did in the 1980s without generating inflation. However, the revisions to economic growth show a much lower trajectory for investment in business equipment (chart). In the three years from 2003 to 200 equipment spending grew 7.3% per year, not 9.8%, as earlier data showed, and outlays for information processing gear rose 9.4% per year, not 12.2%.

Equipment outlays for the second quarter alone, although coming as they did on the heels of a strong firs quarter gain, were surprisingly weak. Spending fell from the previous quarter for the first time in more than three years, as did high-tech investment.

BUSINESS INVESTMENT: LESS THAN YOU THOUGHT



Data: Bureau of Economic Analysis, Global Insight Inc.

A rising amount and quality of equipment available to workers is a key component of productivity growth. However, even before th revisions, the dollar valu of business investment as a share of gross domestic prod was still well below the 12.6% peak reached in the late 1990s. Now, at 10.4%, the share is even lower than before Even after 4½ years of economic recovery, the share remains below the 10.9% average since 1960.

On balance, the BEA's revisions tell a consistent story of less investment, less productivity, fewer profits, more labor income, and higher inflation. That's not a combination that should bring comfort either to the Fe or to investors. ■

CAPITAL SPENDING

Is Business Getting Tighter with a Dollar?

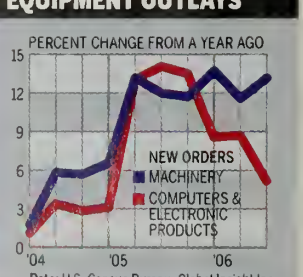
BUSINESSES ARE supposed to carry the economic load in the second half of the year as consumer spending and housing cool off. But recent trends in capital spending indicate that some caution may be creeping into corporate boardrooms.

In the second quarter, new orders for computers and electronic products grew more slowly for the fourth quarter in a row, rising just 5.2% from a year ago, and inventories built up faster. The slowdown in demand and jump in inventories will likely presage a downward adjustment in production in the current quarter.

Some analysts believe the recent softness is partly attributable to the late July release by Intel Corp. of a new processor and price cuts for its other chips, as well as anticipation of Microsoft Corp.'s next Windows operating system, due out later this year for businesses.

However, the second-quarter report on economic growth showed the drop in equipment and software output was concentrated in a category including photocopy, business, and communications equipment. The dip points to a broader pullback in office equipment spending.

A DIVERGENCE IN EQUIPMENT OUTLAYS



Data: U.S. Census Bureau, Global Insight Inc.

Profit margins are getting squeezed by costlier energy and accelerating labor costs, and companies are facing a fuzzier outlook for economic growth over the second half of the year. That combination may be leading some businesses to hold back on investment decisions.

At the same time, figures show investment in other areas remains robust. In the second quarter, new orders for more traditional machin grew 13.2% from a year ago, and unfilled orders are surging, most likely reflecting the boom in export of capital goods. With order books overflowing, production in this sec should remain strong.

Overall business investment is st growing solidly. But the slowdown demand for computers and other office equipment is worth following especially if the economy doesn't sh signs of reviving after a soft second quarter. It could be an early sign th growth in business investment wor pick up as much slack from consun as economists had expected. ■

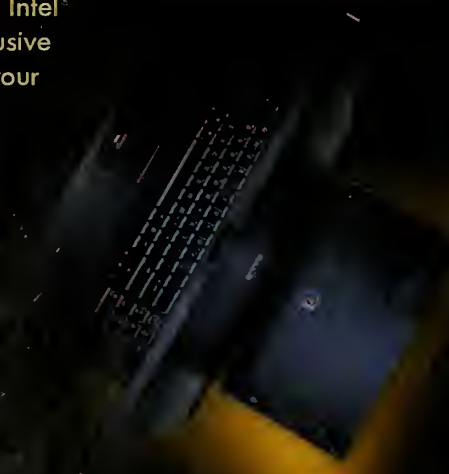
–By James Mehring in New

IP recommends Windows® XP Professional

intel
Centrino® Duo
Dual-core. Do more.

Powerful mobile computing meets powerful backup.
The HP Compaq nx9420 Business Notebook with Intel® Centrino® Duo Mobile Technology, plus HP's exclusive 3-in-1 NAS Docking Station. The ideas that move your business are now secured, simply, in one place.

To back up better, call 1-800-799-MYHP.
Find a reseller or visit hp.com/go/nx9420d.
nx9420 starting at $1329.
Docking Station starting at $349.



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The Business Week

News you need to know

EDITED BY HARRY MAURER

Eating Dust in Detroit Japanese carmakers reached more milestones last month. On July 31 an industry group announced that in fiscal 2005, the Japanese built more vehicles abroad than they did at home. And where are many of those autos finding buyers? You guessed it. In July, **Toyota** sold more cars than **Ford** in the U.S. (a California dealership, photo), and **Honda** passed **Chrysler** as the Japanese companies rode their reputations for offering the most fuel-efficient vehicles. With gas stuck around $3 a gallon, Ford, **GM,** and Chrysler are choking on pickup trucks, and big SUVs are falling from favor with suburbanites.

While GM weighs a hookup with **Renault-Nissan,** Ford is exploring alliances and possible asset sales such as **Jaguar,** part of **Ford Credit,** and Ford's one-third stake in **Mazda** to raise some cash and rev up the company's languishing share price.

See "Is Job One going to be an asset sale?" page 10, and
ONLINE *"July turns up the heat on Detroit," www.businessweek.com/go/tbw*

Pfizer's Surprise Most handicappers had counted him out, but **Jeffrey Kindler** got the job when Pfizer suddenly announced on July 28 that it was replacing **CEO Henry McKinnell Jr.** Kindler, a lawyer with little operations experience, now will try to heal the ailing $51 billion drug behemoth.

See "The lawyer is in at Pfizer," page 26

KKR May Be in the Chips Another private equity de for the record books: On Aug. 1, *The Wall Street Journ* reported that **Kohlberg Kravis Roberts** and partner **Silver La** were poised to win a drawn-out bidding contest again other marquee rivals to buy the chip unit of Dutch gia **Philips.** The $10 billion-plus price is the highest for a sen conductor buyout and values the unit at almost 15% hig er than many analysts thought it was worth. KKR appa ently senses untapped juju in the company's inte lectual-property portfolio and vast array of components.

ONLINE *See "What are KKR's plans for Philips Semi www.businessweek.com/go/ti*

Time for AOL 28.0 His portal is still a mess, but win loving **Time Warner CEO Richard Parsons** can still raise toast of oaky chardonnay. Despite AOL's loss of nearly million subscribers in its most recent quarter, a surpri hike in AOL ad sales helped his company to a better-tha expected $1 billion in second-quarter earnings. AOL's z lionth new strategy: It's eliminating its fee for broadba customers and will offer videos to do battle with t **YouTubes** of the Internet.

Knight's Largesse Well, he just did it. **Nike** founder a **Chairman Philip Knight** on Aug. 1 pledged $105 million **Stanford,** the largest single gift to a B-school. Most of t money is earmarked for a $275 million graduate busine school campus that will be named after Knight, univers officials said. Knight earned a Stanford MBA in 1962 a wrote a thesis that proposed creating a company th would manufacture in cheaper overseas locales.

ONLINE *See "Nike founder gives $105 million to Stanfor www.businessweek.com/go/t*

It's a Gas Being Big Oil Every corner of the oil pat turned in a high-octane second quarter. The integrated ants cashed in, of course, led by **Exxon Mobil's** $10.4 billi profit, up 32% from a year earlier. So did refiners like **Val** (up 124%), service companies like **Schlumberger** (up 25 and drillers like **Noble** (up 145%). Expect more of the sa in the quarters ahead. But with many players ramping multibillion-dollar expansions, the industry could ren its boom-and-bust reputation two to four years from no Investors might ponder that as they bid up share prices

See "Striking it rich in Africa," page 31, c
ONLINE *"Will oil profits run out of fuel?" and "Big Booming profits, rising costs," www.businessweek.com/go/t*

United in the Black When it comes to delayed takeo this takes the cake. **United Airlines,** out of bankruptcy in F ruary, reported on July 31 its first quarterly profit in years. Despite record fuel costs, Chicago-based Uni said it earned $119 million in the second quarter as r enue climbed 16%, to $5.11 billion. All its cost-cutting d ing three years in Chapter 11 certainly helped. So did broad rise in demand, which has allowed the industry jack up fares and still fill its seats. Indeed, all the majors cept bankrupt **Northwest** and **Delta** are making money.

-Mart Says *Auf Wiedersehen* For the world's
est retailer, Germany provided an expensive lesson in
not to enter a foreign market. Wal-Mart underesti-
ed German labor unions and local competitors such as
On July 28, after nine years of losses, Wal-Mart an-
nced it will sell its 85 German stores to Dusseldorf-
d **Metro** for a price one insider says was tens of mil-
s less than the value of unsold merchandise and other
ical assets. Wal-Mart will take a $1 billion charge.

Mercy for Ebbers It's true, 25 years is a long time.
in upholding former **WorldCom CEO Bernard Ebbers'**
5 fraud conviction, the U.S. Court of Appeals for the
nd Circuit on July 28 said his jail sentence "is harsh
not unreasonable." Ebbers, 65, who has been free
ling the ruling, had challenged the sentence as exces-
. At his trial last year, Ebbers argued that former **Chief
ncial Officer Scott Sullivan** orchestrated the $11 billion ac-
ting fraud at the telecom company and that Ebbers
v nothing about it. Sullivan, who copped a plea, is look-
t five years.

n B May Get the Nod Is it morning for the morn-
after pill? The **FDA** said on July 31—a day before a con-
ation hearing for **Acting Commissioner Dr. Andrew von
enbach**—that it may soon approve the sale of the **Barr
maceuticals** anti-pregnancy pill, named Plan B, without
escription to women 18 and over. Agency reviewers
ruled the drug safe for over-the-counter use as far
as 2003, but senior officials overruled them after con-
ative groups objected. In retaliation, some Democratic
tors said they would block von Eschenbach's confir-
on. **Hillary Clinton** (D.-N.Y.) and others warn that they

D.U.I. of the Week

has played a futuristic, hot-rodding marauder, a
lf-crazed police detective, and a guy who can read
men's thoughts. But **Mel Gibson** now seems to be per-
ting another tried-and-true **Tinseltown** role, the self-
structive megastar. His drunken tirade against Jews
er being pulled over by Malibu cops on July 28 has al-
dy cost him one gig, a mini-
ies about the Holocaust for
C. And it may cost him more,
hough **Disney** says it is so far
cking with its plans to re-
se Gibson's latest directorial
ort, the Mayan epic *Apoca-
to*, in December. Even a de-
ed apology to "everyone in
e Jewish community for [my]
riolic and harmful words" may not be enough to re-
re the 50-year-old's luster. Meanwhile, Gibson has
aded off to rehab, Hollywood's under-the-carpet
re-all. Maybe the regimen could include some sensi-
ity training?

MEL GIBSON

ONLINE *See "Disney faces hard sell for Gibson film," www.businessweek.com/go/tbw*

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BIG PHARMA

THE LAWYER IS IN AT PFIZER

Jeffrey Kindler's ascent reflects the new challenges drugmakers face.

BY ARLENE WEINTRAUB

IN THE RACE TO REPLACE HENRY A. McKinnell Jr., the embattled CEO of drug giant Pfizer Inc., Jeffrey B. Kindler was the dark horse. Named as McKinnell's successor on July 28, he had no pharmaceutical experience prior to joining Pfizer four years ago as general counsel. But for months, the drug industry has been racked with legal, regulatory, and public-relations challenges, with Pfizer right in the thick of it. Against that backdrop, the 51-year-old Kindler—an accomplished lawyer and veteran of McDonald Corp. and General Electric Co.—brings much to the table.

Kindler's sudden ascent at Pfizer may be the clearest signal yet that pharma boards aim to change how these sprawling, complicated corporate goliaths are managed. For years, directors have enlisted doctors, scientists, and marketing wizards as CEOs. They were expected to focus on the twin tasks of producing new drugs and persuading patients to ask their doctors about them. Kindler will still be responsible for these matters, but he will also have to craft strategies that have little to do with science or sales pitches. More and more, Pfizer's business will hinge on managing patent disputes, lawsuits arising from adverse drug side effects, and mounting oversight by federal regulators. And the same will be true for all large drugmakers. "These companies will be picking leaders who are thoughtful, careful, and focused on challenges they need to handle today," says Jeffrey L. Moe, senior director of the Duke University Health Sector Management program. As a lawyer, Moe adds, Kindler "is trained to be concerned about risk. I think he's emblematic of a much larger trend."

RETHINKING RELATIONSHIPS

PFIZER DECLINED TO make Kindler available for interviews, but board member Stanley O. Ikenberry says the company needed a leader who could deal with all sorts of issues. First on the list will be fixing Pfizer's broken drug operations: Its top line has flattened, and its mission to develop ground-breaking drugs has [illegible] into trouble. Skeptics might quest[ion] handing this turnaround to a guy wh[ose] only operational experience was runn[ing] McDonald's tiny Boston Market u[nit]. Nonetheless, says Ikenberry: "We ha[ve] general feeling that the external envir[on]ment for pharmaceutical companie[s] changing rapidly. Their relationship[s] patients and physicians needs to [be] rethought. Jeff is a very strategic think[er]

McKinnell's departure may have b[een] sped up by the dysfunctional success process Pfizer's board created. The th[ree] contenders were Kindler and two o[ther] vice-chairmen, Karen L. Katen, who [ran] the prescription drug business, and David L. Shedlarz, who was chief finan[cial] officer for a decade. Each of the three [is] committed loyalists, according to [Jeff] Lindholst, a recruiter for Egon Zehn[der] International, who knows many Pfizer ecutives. "That's not very producti[ve]" Lindholst says. "It takes energy a[way] from the real business." Says bo[ard] member Ikenberry: "There was a fee[ling] that now was the time to move forw[ard] and put this planning phase behind u[s]

The swirl of legal and governmenta[l] sues likely swayed the board tow[ard] Kindler, and these problems will d[emand] plenty of attention. They include pa[tent] battles involving flagship brands suc[h] cholesterol drug Lipitor and paink[iller]

McKINNELL'S LEGACY

Pfizer's stock has languished since McKinnell took over in 2001

Data: Bloomberg Financial Markets

Can Kindler cope with the patent fights, lawsuits, and regulators in Washington?

Pharma's Top Guns

Pfizer's CEO is a lawyer, but his counterparts started out in medicine, manufacturing, or sales

ABBOTT
SALES: **$22.3*** Bil.

Miles D. White
An operations guy with an MBA, he rose to CEO after running Abbott's medical-products unit

ASTRAZENECA
SALES: **$23.9** Bil.

David Brennan
Joined Merck as a salesman and helped build a marketing venture between Merck and Sweden's Astra

GLAXO-SMITHKLINE
SALES: **$37.3** Bil.

Jean-Pierre Garnier
A PhD pharmacologist, he held key management jobs at Schering-Plough and SmithKline Beecham

JOHNSON & JOHNSON
SALES: **$50.5*** Bil.

William C. Weldon
Joined J&J with a BS in biology and ran operations in medical devices and pharmaceuticals

MERCK
SALES: **$22** Bil.

Richard T. Clark
Started in quality control at Merck, ran Medco Health Solutions, then headed up manufacturing

NOVARTIS
SALES: **$32.2** Bil.

Daniel Vasella, MD
Practiced medicine in Switzerland, was product manager at Sandoz, then ran marketing operations

PFIZER
SALES: **$51** Bil.

Jeffrey B. Kindler
Received law degree from Harvard Law School, clerked at Supreme Court, litigated for General Electric

SANOFI-AVENTIS
SALES: **$32.3** Bil.

Jean-François Dehecq
Earned mechanical engineering degree and worked in oil sector before moving to pharma

*Includes significant nonpharma revenue

Data: Company repor

Celebrex, along with claims that Pfizer's sales force improperly promoted some drugs for uses that are not approved by the U.S. Food & Drug Administration. Most recently, a lawyer in New York filed lawsuits on behalf of 19 patients who say the company failed to warn them properly that Lipitor can cause dangerous side effects (box).

Legal woes are endemic in the industry. The day Kindler was appointed, the Justice Dept. launched a criminal investigation of Sanofi-Aventis and Bristol-Myers Squibb Co. over a patent settlement the two companies reached with a generic drugmaker that wanted to market a low-priced version of the blood-thinner Plavix. Such deals are hardly rare, but Congress has been weighing legislation to restrict them on the grounds that they hurt consumers by blocking low-cost generic competitors to expensive drugs.

GOVERNMENT CRITICS

IN ADDITION, SOME Democrats in Congress are seeking to overhaul the new Medicare Part D drug benefit, which was a joint effort by insurance companies and the federal government to subsidize drugs that many seniors couldn't afford. In July, several pharmaceutical companies reported better-than-expected earnings, part of which likely resulted from the new benefit. Critics such as House Minority Leader Nancy Pelosi (D-Calif.) believe drug companies have too much power to control prices. Disgusted by recent estimates that the drug industry will reap $2 billion in profits from Part D this year, Pelosi sent a letter to Speaker J. Dennis Hastert (R-Ill.) on July 20 urging Congress to consider legislation allowing Medicare to negotiate lower drug prices.

The prospect of increased regulations from the federal government makes the Kindler choice look smart, particularly in light of his experience as a Washing lawyer early in his career. Before join the corporate world, he worked at Federal Communications Commiss and then clerked for a judge and Supreme Court justice William J. Br nan Jr. "His ability to be appropria positioned among all the regulat constituencies that this industry to deal with will be essential," says H

LAWSUITS

Statins Could Cause Legal Headaches

Gerald M. Ward never worried much about his high cholesterol. But when the former Air Force pilot applied for a job at American Airlines Inc. four years ago, he was told he wouldn't be hired until he got the problem under control. So Ward's doctor put him on Pfizer Inc.'s cholesterol-lowering statin Lipitor, the world's best-selling drug, worth $12 billion in 2005. Soon after, Ward claims he suffered a baffling set of symptoms: amnesia, depression, and a condition called peripheral neuropathy that causes pain in his hands and feet. Now he's suing the pharmaceutical giant over Lipitor. "It's not safe," according to Ward, 48: "Pfizer has warned the public about this."

Ward is one of 19 patients who filed lawsuits against Pfizer in June and July in New York's Supreme Court. The lawsuits allege that Pfizer failed to inform physician and patients adequately of the risk that Lipitor can cause serious neurological side effects. "Pfizer intends to vigorously challenge in court all the baseless claims made in these lawsuits," the company said a written statement. Lipitor's safety record very well established," the statement said.

Concerns about statin side effects hav been lurking under the surface for years, a confluence of events could turn them ir

Ryan, an analyst for Deutsche . "The fact that he's a lawyer is cer- y powerful."

senior counsel at GE in the 1990s, ler stood out as a capable litigator remained cool under fire. In 1994 ustice Dept. indicted GE on charges it conspired with diamond seller De s to fix prices worldwide. In court, ler cross-examined some of the ecution's witnesses. Six weeks into trial, the judge threw out the ges—a huge victory for the company for Kindler. "He probably had -CEO Jack Welch] pinging him two minutes," recalls Brackett B. niston III, senior vice-president general counsel of GE. "That's a cri- nanager." Says Welch: "We had a ker jack legal team, and he was eader."

indler also impressed colleagues at onald's. He joined the fast-food giant 96 as general counsel, then took over perations role as CEO for Boston ket and chief of all McDonald's ancil- brands in 2000. A down-to-earth ex- ive known for his quick wit, Kindler 't balk when the company asked him ork behind the counter. "He's a very k study and really an exceptional lis- r," says M. Steven Ells, CEO of otle Mexican Grill Inc., which is con- ed by McDonald's.

hile Kindler still has to prove he has makings of a good manager, his hasty appointment at least frees Pfizer from a prolonged and painful succession process. Anthony H. Wild, a former executive of Warner-Lambert Co., which was acquired by Pfizer, says he always detected tension between McKinnell and both Katen and Shedlarz. That may not be surprising, given McKinnell's reputation as a prickly boss who didn't take enough care to foster relationships with colleagues and investors. "McKinnell felt he was a better financial person than anyone," says Wild, who worked closely with McKinnell during the merger with Warner-Lambert. "No matter how much of an expert you are, there's a benefit to listening to other people. That was not his strength." In the end, the fact that Katen and Shedlarz are longtime Pfizer insiders burdened them with far more baggage from the company's poor performance. Pfizer declined to make McKinnell, Shedlarz, and Katen available for interviews.

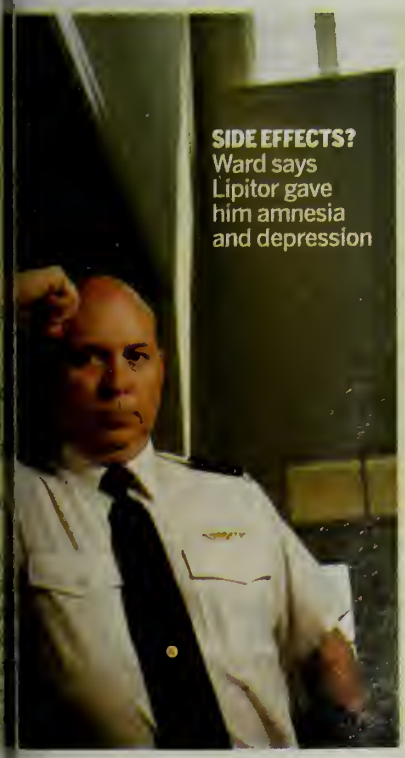
PIPELINE PAIN

INTERNAL JOCKEYING aside, few are surprised that Pfizer's board wanted McKinnell out now—more than a year earlier than expected. Since he took the helm in 2001, Pfizer's stock price has dropped 43%. The American Stock Exchange pharmaceutical index, by contrast, dipped just 22% in that period. Hit Pfizer drugs such as Zoloft for depression have lost their patent protection. In October, Pfizer lowered its sales and profit guidance for 2005. In its most recent quarterly earnings release, the company admitted that its previous prediction that top-selling cholesterol drug Lipitor would hit $13 billion in sales this year is now a "stretch" goal. "Pfizer had a number of downward revenue revisions," says David S. Moskowitz, an analyst for Friedman, Billings, Ramsey Group Inc. "You have to believe board members were scratching their heads."

And Pfizer can't seem to squeeze many replacement hits out of its pipeline. Some of its new drugs have been delayed or failed to catch on. Most recently, Pfizer pushed back the release of Exubera, an inhalable form of insulin that the company hopes to turn into a $2-billion-a-year blockbuster. Facing new generic competition to Lipitor, Pfizer is racing to develop a next-generation cholesterol-control therapy, but early data have raised concerns that the drug may cause high blood pressure.

On July 31, Kindler e-mailed a memo to all Pfizer employees. "To meet our challenges in a rapidly changing industry, we will need your continued help," he wrote. "I would like to discuss our challenges openly... and, most of all, put you in the best possible position to succeed." The e-mail was headlined: "We move forward from a position of strength." ■

–With Michael Arndt in Chicago and Diane Brady in New York



KATHERINE LAMBERT

Pfizer insists that Lipitor's safety record "is very well established"

a major headache for Pfizer and other statin makers. In addition to the Lipitor lawsuits, scientists at the University of California at San Diego have spent the past six years tracking 1,000 patients in a trial. Some of the participants have been taking Merck & Co.'s Zocor and Bristol-Myers Squibb Co.'s Pravachol, while the rest receive a placebo. "It's very clear there's a lack of familiarity by patients and physicians about neurological side effects," says Dr. Beatrice A. Golomb, assistant professor of medicine at UCSD and the lead investigator. "That sometimes hurts patients."

The labels on statin medicines do, in fact, include warnings to the effect that some patients have developed memory loss, muscle pain, and other adverse side effects. But critics say the risks are underplayed. Ward's lawsuit, for example, quotes the Lipitor Web site as saying "Lipitor has a proven safety profile," and "Lipitor has been proven to be as safe as taking a sugar pill."

Despite such promotional language, the patients suing Pfizer have a tough task ahead of them. They must demonstrate that Lipitor actually caused the symptoms that plague them. "And they have to prove the company knew more than they warned," says Paul Rheingold, a New York attorney who is not representing any of the plaintiffs. "That will be extremely difficult."

Ward, who lives in Ashburn, Va., says he is willing to do whatever is required. He recently left the airline industry because he feared his lingering neurological problems made him a danger to himself and to his passengers. "All my life I wanted to fly," says Ward, who now works part-time at a desk job with the Air Force Reserve. "The thing I love the most, I can't do anymore."

PRIVATE EQUITY

MASSIVE BUYOUT, LITTLE WIGGLE ROOM

The $33 billion HCA deal will have to work perfectly to work at all

BY TIMOTHY J. MULLANEY

IF MOST PEOPLE WERE BETTING $33 billion, they'd bank on things they could control. Not the backers of the leveraged buyout of HCA Inc., the nation's largest for-profit hospital chain, with 183 hospitals and 94 same-day surgery centers. The stunning thing about the July deal isn't its size; it's the fact that the company's management and buyers, led by private-equity firm Bain Capital, have put so many chips on factors that are out of their hands.

The biggest leveraged buyout in history will have to break nearly perfectly to work. According to a Jefferies & Co. analysis, the investors should expect returns of around 16% a year, after fees, on the $6 billion in equity they put in the deal. (An additional $16 billion is to be borrowed, and the buyers will assume nearly $11 billion of existing debt.) "By recent standards, 16% is not high," says Mario L. Giannini, chief executive officer of Hamilton Lane, a Bala Cynwyd (Pa.) firm that raises capital for buyout funds. According to Thomson Financial, the average buyout fund returned 31% last year.

What's more, the 16% estimate assumes that HCA can exempt itself from industrywide dips in hospital admissions and spikes in bad debt. This means management must turn profit declines in 2006's first half into consistent gains, despite bad industry trends. Most of all, the numbers demand that when HCA sells itself back to public investors in a few years, as Wall Street expects, it will command a sharply higher price-earnings multiple than it had before.

Pulling off such a trifecta will be difficult. For the owners to make the deal work over five years—the typical horizon used to evaluate buyouts—they'll need to take HCA public at a price of about eight times 2011 earnings before interest, taxes, depreciation, and amortization, or EBITDA. Before the buyout, the company was trading at about six times EBIT

HCA also will have to show that it boosted profits to earn that higher mu ple. Jefferies says HCA must incre EBITDA by 5% a year to make its nu bers. But in the first half, EBITDA fell to $2.26 billion.

TIGHT BUDGET

TO TURN THAT around, HCA must costs or boost revenues. Each looks di cult. HCA's operating profit margin 8.8% in 2005 trounced the industry av age of 3.6%—so it's not obvious where would come from. An HCA spokesman clined to comment, but in meetings w employees after the deal was announ that were described in regulatory filin executives said capital spending will s at current levels of between $1.5 bill and $2 billion a year. (Spending had ready been cut by $300 million betw 2003 and 2005.) Management also sai doesn't expect to spin off less profitable cilities to pay down debt.

Boosting sales looks tough, too. more people in beds, and profits sharply, since hospitals are alre staffed and equipment paid for. But in first half, HCA's total admissions 0.1% from 2005, with profitable surg admissions falling 1.2%. "You're mak a $33 billion bet that patient volume get better," says Jefferies analyst Fr Morgan. "That's the bottom line."

The admissions trends show how much of the deal's fate is ou its backers' control. One factor is rising number of Americans with health insurance: more than 45 lion last year, up from less than 40 lion in 2000. Stingier benefits for ple with insurance are also contribut to an explosion in bad debt: In the sec quarter, HCA put aside $677 millio guard against patients who don't their bills, up 25% from last year. E the aging baby-boom generation helps tle. Paul B. Ginsburg, head of the Ce for Studying Health System Chang Washington, says boomers will boost missions rates by only 0.75% a year. not a good time to be a hospital," he s

The HCA deal was highly levera even by recent Wall Street standa Some 80% of HCA's projected valu debt, more than the 60% to 70% c mon in recent LBOs. Without extra le age, returns would be even skinnier. annini says the numbers do indeed w for now. But if life gets messier than pected for HCA's owners after the s don't be surprised. They've left l room for error.

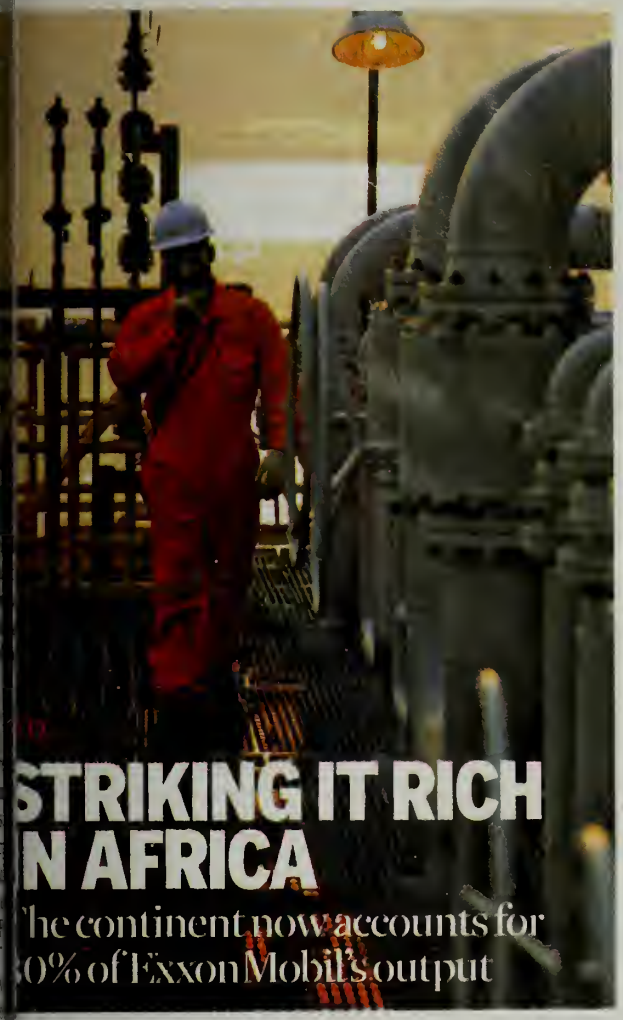
Impatient For Patients

The LBO's backers are making a huge bet that HCA's patient volume will increase

HCA Growth in Hospital Admissions

2004	2005	2006 (1ST HALF)
0.7%	0.1%	−0.1%

Data: Securities & Exchange Commission filings



STRIKING IT RICH IN AFRICA

The continent now accounts for 30% of Exxon Mobil's output

OFFSHORE
Angola is the fastest-growing major oil producer in Africa

CHRISTOPHER PALMERI

THE OIL-RICH MIDDLE East is in turmoil, Venezuela's state-run oil company is a mess, and U.S. oil production keeps edging downward. Fortunately for motorists gasping over $3-a-gallon gasoline, there's a place on the planet where oil production is flourishing: Africa. Daily output in African nations that are not members of OPEC rose 25% from 2002 through 2005 and should climb an additional 35% by 2010, estimates researcher Wood Mackenzie in Edinburgh, Scotland. The world's largest oil company, Exxon Mobil Corp., revealed July 27 that its production in all of Africa has doubled in three years and now accounts for 30% of its worldwide output—more than its output in the U.S. and Canada combined.

Surprised? No wonder. Most of the headlines about oil in Africa concern turmoil in Nigeria, where thugs and rebels steal oil, kidnap workers, and sabotage pipelines and production sites. But those problems, bad as they are, obscure plenty of good news elsewhere on the continent, especially among the non-OPEC producers led by Angola. About 30% of non-OPEC African oil comes from deepwater fields that are far offshore and relatively immune to theft and vandalism. National governments, while sometimes corrupt, have been receptive to foreign investment. The quality of the oil is excellent: light and sweet, so it's easy to refine. And it's a straight shot across the Atlantic from West Africa to the East and Gulf coasts of the U.S. Add it all up, and "this is the new North Sea," says Lysle Brinker, a senior analyst at energy research firm John S. Herold Inc.

ExxonMobil has made the most of the African opportunity. It has brought six fields online in the past three years in the waters off Nigeria and Angola. African oil contributed to a robust 6% rise in Exxon's worldwide oil and gas production in the first half of 2006 from a year earlier. That was Exxon's first significant production increase since 1999. In contrast, output was down 5% at Royal Dutch Shell and 2% at BP. Acquisitions masked a decline of 5% at Chevron and no growth at ConocoPhillips, according to Jacques Rousseau, an oil analyst at Friedman Billings Ramsey.

The roots of ExxonMobil's success go back to the early 1990s, when Mobil—which Exxon agreed to buy in 1998—bid extensively for West African exploration rights. In the years since, the company has proven especially adept at bringing the new fields online. It contracted for three giant production vessels at once, for example, to speed development time and cut costs. Thirty or more wells can connect to each of these specialized vessels, which look like oil tankers but are stationary.

TINDERBOXES

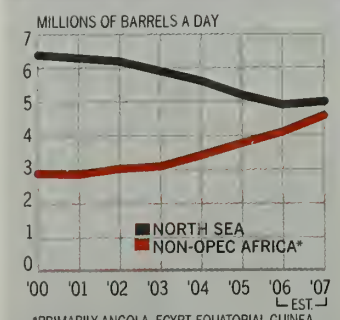
OTHER BIG OIL COMPANIES are chasing similar opportunities. In fact, West Africa accounts for about a quarter of all exploration and production spending by the oil majors. Angola alone is expected to provide 19% of all new non-OPEC oil production in the world over the next five years, second only to Russia, according to Wood Mackenzie. Recognizing a good thing, the Chinese also are competing aggressively for prospects. Beijing has loaned $5 billion to the government of Angola. China's CNOOC Ltd. paid $2.2 billion for an interest in a big Nigeria field in April, while Sinopec Ltd. has bid a similar amount for two Angola fields.

Africa presents challenges, of course. Both Nigeria and Angola, the fifth- and seventh-largest suppliers of crude to the U.S., are tinderboxes whose recent histories have been marred by civil war and corruption. Citizens complain, with justification, that their oil wealth is not being evenly distributed. Shell was forced to shut down two-thirds of its production because of attacks on oil platforms and a pipeline leak in Nigeria's shallow waters.

What's often overlooked, however, is that African oil production outside of Nigeria is climbing at a good clip. Even troubled Nigeria is far from a basket case: Wood Mackenzie expects its daily output to rise more than 30% from 2005 to 2010. Says George Ayittey, a distinguished economist in residence at American University in Washington: "It's not as dangerous as the Middle East. It's offshore.... It could be a win-win for the U.S. and Africa."

–With Mark Morrison in Austin, Tex.

ON THE RISE



*PRIMARILY ANGOLA, EGYPT, EQUATORIAL GUINEA, SUDAN, GABON, CONGO, SOUTH AFRICA, CHAD. EXCLUDES NIGERIA, ALGERIA, AND LIBYA.
Data: Wood Mackenzie

THE BUSINESS LOBBY

A TRADE WAR RIGHT AT HOME

A deepening rift over China pits big U.S. companies against small ones

BY LORRAINE WOELLERT

FOR DECADES, WASHINGton's business lobby has led the charge for trade liberalization, with companies standing shoulder to shoulder in support of tariff-busting and free-market pacts.

Now that united front could be crumbling. A rift at the National Association of Manufacturers over trade with China points to a deepening division within the business community that reaches far beyond the Beltway. The split pits smaller U.S. manufacturers, who want the U.S. to combat the trade imbalance caused by China's currency manipulation, against their larger and more global peers, some of which are benefiting from the undervalued Chinese yuan. If the little guys prevail—as they did in an early skirmish—NAM, with 12,000 members, could become the first major group to endorse broad trade sanctions against a major trading partner.

"It is an extremely troubling sign," says Stuart E. Eizenstat, an adviser to President Clinton and now a law partner at Washington's Covington & Burling. "The universally accepted notion that the business community would always be there for free trade initiatives is beginning to splinter."

On Sept. 27, NAM's 250-member board of directors will consider endorsing legislation that would allow the U.S. to retaliate against China and other countries that manipulate their currency to gain an export edge. Caterpillar, General Electric, Cargill, and others that benefit from cheap Chinese labor and exports, oppose the bill.

Normally, this would have been enough for NAM. But all that changed on June 29. In a surprise revolt, smaller NAM members showed up in droves at a meeting of the group's trade-policy committee to out-vote larger members. By a 75-46 margin, the panel endorsed the Chinese Currency Act of 2005, a bill from Representative Tim Ryan (D-Ohio) and House Armed Services Committee Chairman Duncan Hunter (R-Calif.).

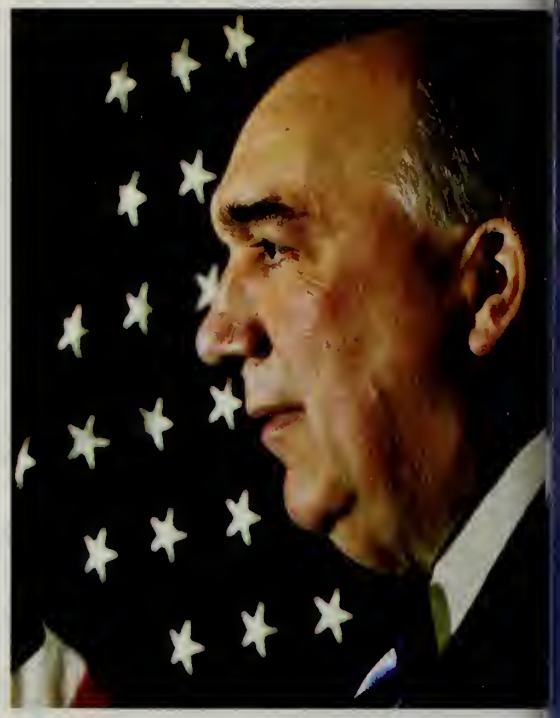
JOB LOSSES

THE MOVE CAPPED two years of planning by small manufacturers, which are suffering revenue and job losses as customers—often big manufacturers—move operations offshore. "These mostly small companies assumed our trade associations were doing a great job representing us," says David W. Frengel, director of government affairs for Penn United Technology Inc., a precision tooler just north of Pittsburgh. "We found out that our trade association policies were being dictated by the folks who show up at the meetings, mainly big multinationals who had full-time government affairs staff in Washington." So Frengel organized smaller companies to push their own agenda. They took their fight to NAM because its bylaws gave them a significant voice in policymaking decisions.

It's not unusual for a particular industry to take a hard line on a particular trade pact; U.S. textile makers balked at liberalization deals with Africa in the 1990s, for example. And internal discord isn't new to business groups. But it's exceptional for such a broad-based and influential lobby to be torn over free trade. The globalization pushback is being fed by a confluence of events, including job losses and the increasing economic clout of China. "China is waging a mercantile war, and we're losing pacifists," says M. Brian O'Shaughnessy, president of Revere Copper Products Inc. in Rome, N.Y.

Large NAM members declined to comment on the record or didn't return phone calls. But some agreed privately that NAM's thousands of small members could be the most important voice to join the growing fair-trade cacophony.

Regardless of how the board votes, NAM President and CEO John Engler will find himself in a tough spot. Small companies are threatening to quit if the trade group refuses to take a tougher stand on China. But the multinationals, which provide the bulk of NAM's $23 million annual revenue, fear that a hard line could lead to retaliation against their operations there, or worse, erupt into a full-blown trade war. "There's no law we can pass here that can fix China's currency if the Chinese government doesn't want to," Engler says.



NAM'S ENGLER
Can he keep the anti-China faction from bolting?

THE STATS

Small and midsize companies make up

74%

of the membership roster at the National Association of Manufacturers, but they kick in only

23%

of the organization's annual dues

Data: National Association of Manufacturers

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WHISKER CAMPAIGN

A BLADE TOO FAR

Gillette's Fusion gives a close shave, but the price cuts deep

BY DAN BEUCKE

ABOUT 20 YEARS AGO, I laid down my razor. It was a Trac II—state-of-the-art, twin-blade technology at the time. (I still remember when they added the lubricating strip—brilliant!) Shortly afterward, the razor companies launched their bizarre arms race. Pivot heads were followed by spring-loaded blades. Mach 3 begat Mach 3 Turbo, and was countered by Quattro. Now there's Fusion, Gillette's five-bladed wonder that hit the stores back in January. To believe the TV ads, all this was necessary because beard hairs require ever more blades and technology to coax them out for snipping. I just watched from the sidelines, rubbing my beard in bemusement.

But recently, faced with the encroachment of middle age and more than a few gray hairs, I decided to return to the world of shaving. I figured I would pick up where I left off, with my trusty twin-blade. But then someone suggested this was an opportunity to put cutting-edge razor technology to the test. What if Gillette's R&D labs really had cracked the secrets of the beard-cheek boundary? My face, preserved as a kind of old-growth forest, would be the perfect proving ground.

I ventured forth to the local drug store and selected a new Fusion Power razor and pack of eight replacement blades. The clerk rang me up: $39.98, before taxes. Hello? Good thing my employer is paying for this little exercise. In my household, $40 is what you pay for a month of cable TV, not a grooming tool.

Apparently I'm not alone on that score: There are signs men are balking at Fusion's high price tag. Despite big discounts and massive advertising, sales of Gillette's latest wonder have fallen short of expectations, some analysts say. This is bad news for Procter & Gamble Co., which paid $57 billion last year to buy Gillette, largely for its ability to rake in unprecedented profits with each increase in razor price and blades. On Aug. 2 the company reported 36% higher quarterly earnings, and put a rosy spin on razor sales.

Placing cost concerns aside, I lather up. The first point I'd like to make about shaving with five blades is that it's hard to tell where to put them. With two blades, the business end of the razor is thin enough that you can place it where the beard begins and start pulling. But the blades in the Fusion are embedded in a device that seems to cover my entire face (O.K., it's maybe a half-inch wide, but still). I guess this is why they added the single Precision Trimmer blade on the top of the razor. What I really don't get, though, is the "power" in the battery-ope ated version, Fusion Powe Push a button and the raz hums. How this helps th morning clear-cut escapes m

LATHERED UP Beucke puts Fusion to the test

For kicks, I shave one sid with the Fusion and the oth with my old Trac II. Th Fusion side is definite smoother. But eight time smoother? That's the diffe ence between the $3.50 I' paid per Fusion cartridge an the 40¢ I pay per twin-blade cartridge.

I know, Gillette says these new blad last longer. Maybe even a month longe But for a guy who insists on squeezi every last gasp out of a can of Barbas each Fusion cartridge would have to la about a year to justify its price. I'm al left wondering, how do you know wh the blades are shot? If one goes, can t other four plug along for a while, like 747 flying on three engines?

My advice to Gillette: Keep cutting t price. And think about that nam "Mach 3" speaks of power and, of cours three blades. And it's hard to misinterp "Trac II"—there are two tracks, and y can guess that each one has a blade. Tha what I'll be using once my expense-a count allotment of Fusion cartridges ru out. The good news is, I think I can m them until about 2009. ■

–With reporting by Robert Ber

Sharp Inflation

How Gillette has turned the humble razor into an increasingly expensive technology platform

SENSOR EXCEL
2 Blades
1994
Start-up pack
$4.49
Refills up to:
$5.29
for 5

MACH3
3 Blades
1998
Start-up pack up to
$6.99
Refills up to:
$6.79
for 4

FUSION POWER
5 Blades
2006
Start-up pa
$11.9
Refills up t
$14.0
for 4

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FRANCE

LA VIE IMPOSSIBLE

Paris is encouraging entrepreneurs even as it continues to hinder them

BY ERIC SCHINE

FRANCE'S GOVERNMENT wants the world to know something. According to official figures, French citizens created a record 322,000 companies in 2005—and they're setting a similar pace this year. Is France, which invented the word "entrepreneur" but has been famously hostile to the breed, finally helping small-business people thrive?

Yes and no. The state has been trying to sweep away many of the outdated laws and regulations that have made life complicated for small-business owners. But French entrepreneurs continue to face cultural, bureaucratic, and financial hurdles. Even the government acknowledges that most businesses created each year are tiny, with scant prospects for growth. Says Philippe Bloch, co-founder and former chief of Columbus Café, a chain of espresso bars in and around Paris: "You have to be crazy to be an entrepreneur in France."

To outsiders, France can be a baffling place. Yes, it is a modern, postindustrial country. But since at least Louis XIV, the government has wielded enormous, even stifling, power. At the same time, the country still breathes in the spirit of the French Revolution, mythologizing the virtues of peasants and factory workers, even if few of them remain.

Caught in a sort of no-man's-land between the powerful state and the heroic worker is the small businessman. It's not always a pleasant place to be. "In France, a self-made man is viewed as a sort of scoundrel or gangster," says Francis Holder, the 66-year-old founder and CEO of Holder Group, an industrial baker that supplies McDonald's Corp. in France and operates a chain of more than 300 *boulangeries* in Europe, Asia, and the U.S.

Holder's experience is instructive. The son of a poor baker, he overcame enormous odds to build his business. He worked 18-hour days, endured several near-death business experiences, and was forced to be much more competitive than the culture generally tolerates. Were Holder in America, he would be feted as a classic up-by-the-bootstraps success story. Not in France. Despite creating thousands of jobs, Holder remains an outsider in the clubby world of French business and politics. "In France," says Holder's son Maxime, "a soccer star scores a goal and gets the Legion of Honor. My father is not likely to ever get it."

***PAIN* MAN**
Holder is one of France's leading entrepreneurs

If Renaud Dutreil had his way, peo like Holder would be accepted and ev celebrated by their countrymen. Dutrei Minister of Small & Midsize Enterpri Before his arrival in 2002, the minis was a backwater. But Dutreil, 46, is qu unlike his predecessors. He rememb the humiliation he felt as a teen when father's tannery went bankrupt. And has set out with a passion unheard of France to help small businesses.

Dutreil's achievements so far will se banal to an American. For example, ditched a law that had made it illegal run a business from home. He also led charge to cut taxes, ease financing quirements, and lighten bankrup penalties. And to help boost animal sp its in a nation where fear of failure is demic, Dutreil twice crisscros France in a spe train to meet w entrepreneurs. says the refor

TOO MANY HAGGLES
Big business is a nightmare to deal with, says Faure

> "In France, a self-made man is viewed as a sort of scoundrel or gangster"
>
> *–Francis Holder*

e helped cut the jobless rate from 11%)%. "By most countries' standards, ve doing nothing original," he says. Et for France, creating a culture of vth is very new."

IVARE THE CODE

BLEM IS, THERE'S only so much reil can do to restrain the heavy hand he state. His power does not extend to infamous Inspection du Travail. The ncy, whose origins date to Napoleon, set up to ensure that companies n't exploiting workers. Today, some 0 inspectors troll the business by- s of France looking for people who working too hard.

couple of years ago, Columbus Café nder Bloch ran afoul of the Inspection Travail and found himself in criminal t. An inspector had noticed that one of h's managers had worked 10 hours er than the state-mandated 35 per k. The fact that she was filling in for shows didn't matter. Bloch, now 47, was found guilty of "obstructing the duties of an inspector" and slapped with a suspended fine of 2,000 euros (just over $2,500 at today's exchange rate). "I was sitting between two guys, one charged with killing three people, and [one] charged with raping his secretary in the parking lot," he recalls. "I said to myself, 'What the f--- am I doing here?'" French officials say the laws protect workers. Still, they concede that the Inspection du Travail can come on a little strong. Says French Budget Minister Jean-François Copé: "Our people are sometimes aggressive."

Then there's the massive 2,732-page Code du Travail. The laws are so complex that even small companies spend thousands of hours a year ensuring that they are in compliance. Augustin Paluel-Marmont, 30, runs Michel et Augustin, a maker of cookies and breakfast snacks that's loosely modeled on Ben & Jerry's Homemade Inc. Despite having just seven office staffers, he employs a full-time head of human resources who spends his days running around Paris trying to locate official forms and then filling them in. Says Paluel-Marmont: "Your first hire must be a human resources manager, or you're dead in the water."

If the overweening state doesn't drive French entrepreneurs to distraction, the business Establishment might just finish the job. Amélie Faure, CEO of Pertinence, a small software company that helps the likes of Wyeth, BMW, Airbus, and Siemens boost manufacturing efficiency, says dealing with her own countrymen can be maddening.

After agreeing to buy her products, the subsidiary of a French aerospace conglomerate failed to pay on time. A lengthy renegotiation ensued, and at the end of six weeks of haggling, Faure, 42, walked away. "They spent months trying to get us to lower our price by 10,000 euros," she says. "But every month they had our product would have saved them 200,000 euros. This was very stupid and frustrating—a real waste of time."

In the end, many French with entrepreneurial yearnings jump ship. Every year, thousands of France's most promising youth decamp for London, New York, Silicon Valley, and beyond to seek their fortunes. They may vacation at their families' country houses in Normandy, Brittany, or the Côte d'Azur. *La belle vie*, after all, will always be in France. But their business dreams, they figure, will come true more easily far from the reach of the Inspection du Travail.

THE STAT

French entrepreneurs created a record **322,000** businesses last year, though the government acknowledges that many of these are tiny.

Data: Ministry of Small & Midsize Enterprise

HAVANA As Castro undergoes surgery, workers rally to show their support

THE AMERICAS

VISIT TO AN ISLAND FROZEN IN TIME

Our reporter finds scant evidence that Cuba is poised for change after Castro

BY FREDERIK BALFOUR

CAN FIDEL CASTRO LIVE forever? Many Cubans—Castro included—seem to think so. Of the various jokes playing on the aging leader's longevity that I heard while traveling in Cuba in July, the best one goes like this: On a visit to China, Castro's hosts present him with an elephant. It's a perfect pet, they say, and it will live to be at least 100. "It is a beautiful gift, but regrettably I cannot accept it," Castro laments. "I would be heartbroken when it dies."

Castro claims to have survived dozens of attempts on his life, including many a botched CIA plot. But with the leader now in the hospital and his brother Raúl at least temporarily in charge, many observers are wondering if he is finally about to exit. Truth be told, neither Fidel nor Raúl was much in evidence during my 11-day visit. Both were featured at the Revolutionary Museum, but Cubans seem to soft-pedal their propaganda, at least compared with China and Vietnam, two other communist nations I have reported from.

I wasn't in Cuba on assignment. I was on vacation and told few people about my job as a correspondent for *BusinessWeek* in Hong Kong. Let's be clear: Although you don't see a lot of cops, and those you do see are unfailingly polite, Cuba is still a police state, and people are afraid to speak their minds, especially to foreigners. For that reason, nearly everyone I spoke with requested anonymity.

Although I left Cuba before Castro announced his illness, I saw little evidence that the country is poised for any significant change. Cuba appears to be frozen in time, with the same empty storefronts, crumbling Colonial-era buildings, and ancient Chevys, Buicks, and Chryslers everywhere. The antique jalopies operating mainly as taxis often carrying three passengers at a time. But since taxis are a luxury for most Cubans and even bicycles are difficult to come by, buses are the most common mode of transport. Cuba's buses are notoriously unreliable, with waits of an hour or more common. Once a bus arrives, it's likely to be a converted 18-wheeler jam-packed with passengers.

> You don't see a lot of cops, but people are afraid to speak their minds

THE LUXURY OF SOAP

THIS IS A COUNTRY of extreme scarcity. Even basic items such as shampoo and soap are untold luxuries sold only in special shops requiring hard currency or a special scrip called the CUC. That's why enterprising Cubans park themselves outside five-star hotels panhandling for toiletries that can be resold on the black market. Others supplement their official salaries of perhaps $15 per month selling whatever they can. Many families keep their front doors open, using their living rooms as storefronts hawking everything from second-hand shoes to spare parts for various machines to meat and vegetables.

Some are tapping into the tourist trade. While Americans are forbidden to visit, citizens of most other countries are welcome to do so (I'm Canadian), and last year 2.3 million tourists came through. That has created opportunities for people such as the couple I stayed with in Havana. Both former lawyers, they quit their jobs and converted their two-bedroom apartment into a guest house, charging $25 per night. Even after paying a big chunk of that to the government, they are very well off by Cuban standards.

To be fair, Cuba boasts excellent social services. The country's free education and health care are the envy of its Caribbean and Latin American neighbors. Cuba has sent hundreds of doctors and teachers to Venezuela, which in turn has helped keep Cuba afloat with cheap oil. Of the dozens of developing countries I have visited, nowhere does the divide between the haves and the have-nots appear to be so narrow, though that is largely because almost everyone is a have-not.

No matter what he thinks, Castro won't outlast the elephant. And just about every Cuban I met hopes his departure will lead to more haves than have-nots. ■

BusinessWeek online For a slide show and other stories on Cuba, please visit businessweek.com/extras

HINA

MAD AS HELL IN CHINA'S BLOGOSPHERE

pinionated Netizens are unleashing a ood of complaints against corporations

BRUCE EINHORN

ZHANG MIN WAS MIGHTY peeved. In June he bought a $1,000 notebook PC from Dell Inc., but when the machine showed up at his Shanghai apartment, it wasn't exactly what he had ered. Instead of the Intel Core Duo 300 processor he had expected, the nputer had a T2300E, which ks "virtualization technology," eature that allows the com- er to run more than one erating system at a time. l says it's of little use to top users, but Zhang s he wanted it anyway. A few years ago the year-old Zhang might have gotten very with his gripe. But million Chinese are izens of online forums, king it easy to find folks with uivalent complaints. Zhang ned up dozens who had gotten 300E processors instead of the 300—as well as a lawyer who was dy to sue Dell. So Zhang has lodged first of what could be a flood of lawsuits inst the PC maker. The computer "is ssing a function," Zhang says. "There a lot of people with similar problems." Chalk one up for the power of the Chi- se Internet. While criticizing the gov- ment online is still taboo, there are few nstraints on airing grievances about porate behavior. In thousands of In- net forums, the mainland's millions ely point out poor customer service, sleading ad campaigns, shoddy safety ndards, and much more. Americans ink the Internet in China is controlled d censored," says Sam Flemming, ief executive of CIC Data, a Shanghai search firm that tracks Chinese online ums and blogs. But when it comes to commenting on business, "Chinese people are vocal and active."

And when they raise their virtual voices in unison, they get the attention of both homegrown companies and multinationals operating in China. Online critics blasted Volkswagen after the automaker launched an advertising campaign that appeared to poke fun at public transportation. Last year General Mills Inc.'s Häagen-Dazs brand suffered a blow when bloggers circulated rumors that the company's ice cream was made in an unsanitary factory in the southern city of Shenzhen. Häagen-Dazs doesn't even have a plant in the city, but that didn't prevent the faulty information from spreading through the Chinese blogosphere. "Companies can get really screwed if they don't" pay attention to bloggers and online forums, says Shaun Rein, founder of Shanghai-based China Market Research Group.

WIN THEM OVER

SOME SMART companies are paying attention and trying to win over China's opinionated Net users. Shoemaker Converse and chewing gum giant Wm. Wrigley Jr. this spring conducted a joint promotion online, encouraging Chinese to come up with cool designs for Converse sneakers that featured the logo of Wrigley's Juicy Fruit (page 78). And in April, Yum! Brands Inc.'s KFC Corp. did an about-face after one of its TV commercials came under fire online. The spot depicted a hardworking student who didn't pass his exams and two carefree kids who enjoyed KFC fried chicken and did well on the test. Denounced online for suggesting that hard work doesn't pay off, KFC changed the ending of the ad to show all three passing.

Dell is taking a harder line. There is no difference in performance between the two processors, and the virtualization technology is a feature that's oriented toward server computers, says Judy Low, a Dell spokeswoman in Singapore. She does acknowledge that Dell made "an error" in not telling customers about the switch ahead of time. She says the computer maker has sent notes to its Chinese customers explaining its position on the matter but hasn't offered any compensation.

Some companies are harnessing the power of the Net to figure out what the public wants. Alibaba.com Corp. controls Yahoo! China and also runs TaoBao, a free rival to eBay Inc. and the mainland's No. 1 auction site. After TaoBao tried to introduce a paid service last spring, users balked. So the outfit conducted an online survey of its 20 million customers and discovered that 62% were turned off by the service. "We told [our] people, 'Let's take it down,'" says Jack Ma, chairman and CEO of Alibaba.com. "We listen to our customers."

THE STAT

53 MILLION

Chinese visit online forums regularly

Data: CNNIC

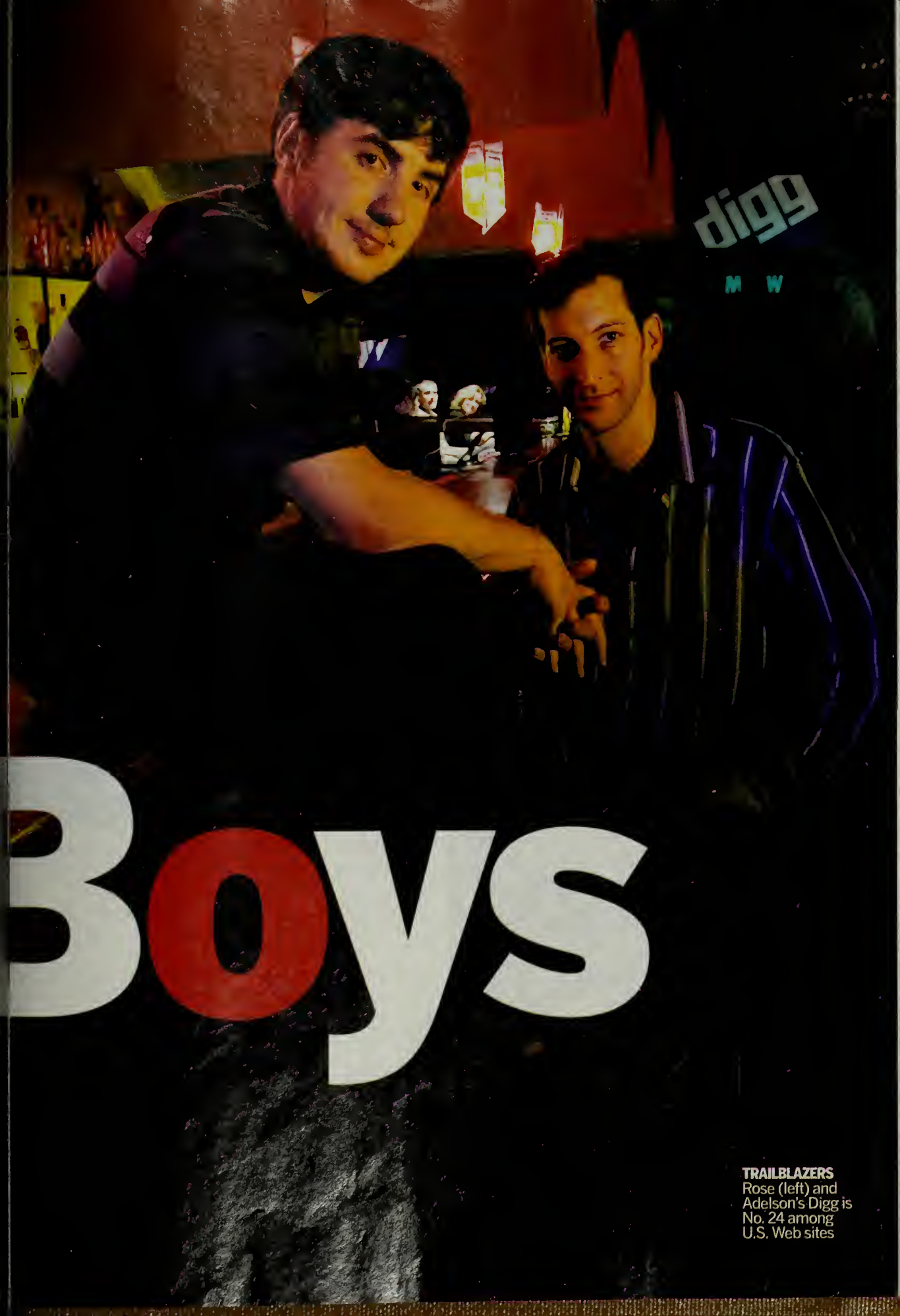
Valley

Digg.com's Kevin Rose leads a new brat pack of young entrepreneurs

BY SARAH LACY AND JESSI HEMPEL

IT WAS JUNE 26, 4:45 A.M., AND DIGG FOUNDER KEV Rose was slugging back tea and trying to keep his ey open as he drove his Volkswagen Golf to Digg's headqua ters above the grungy offices of the *SF Weekly* in Potre Hill. This was the day Rose would test everything. T years earlier, Rose had gambled on his idea to chan newsgathering, letting the masses "dig up" the most i teresting stories on the Web and vote them onto his onli "front page" on Digg.com. Rose had given every last pie of himself to the project—all his time, all his cash, and ev his girlfriend, who fought with him after he poured his savings ir his company instead of a downpayment on a house. Today, Di Version 3, the one that would go beyond tech news to include p itics, gossip, business, and videos, was going live. At 29, Rose w on his way to a multimillion-dollar future or abject failure.

As Rose sat in the middle of the office, managing a final cou down, a Puma cap yanked over his eyes, his posse of twenty- a thirty-something engineers sat at their desks with continger plans and extra servers ready. They flipped the switch. Stor started trickling in. The pace picked up, and suddenly, it wa deluge. Digg staffers grew frenzied, screaming at one other stay one step ahead of the traffic. By 4 p.m. on launch day, the s had signed up more than 13,000 new registered users, eight tin the average number. Traffic was clocking in at four times the v ume of the previous Monday. News of Digg's launch was lighti



Boys

TRAILBLAZERS
Rose (left) and Adelson's Digg is No. 24 among U.S. Web sites

up the blogosphere. An exhausted Rose collapsed for a nap under his desk.

Digg's stature changed dramatically that day. It is now the 24th-most popular Web site in the U.S., nipping at the *The New York Times'* (No. 19) and easily beating Fox News (No. 62), according to industry tracker Alexa.com. More than 1 million people flock to Digg daily, reading, submitting, or "digging" some 4,000 stories. As on many Web 2.0 sites, people register and create online profiles. Then these "diggers" can upload links to stories and blogs they want to share from other news portals like Yahoo! News or mainstream media sites like *The Washington Post.* Users can click a "digg it" button that essentially casts a vote for the content. They can also hit the "bury" button. The stories with the most "diggs" zoom to the top of the page. Of the free labor that is the "Digg Army," 94% are male; more than half are IT types in their 20s and 30s making $75,000 or more. It's a demographic advertisers lust after.

Community First, Ads Later

THAT'S WHY SOME SMART MONEY is on Digg to become an ad magnet à la MySpace.com. Some even refer to Digg as the new *New York Times.* News sites are discovering they can benefit too: Get a story on Digg's front page, and in comes a flood of traffic from people clicking on the link to read the story on your site. Digg gets advertising via Federated Media, the company Silicon Valley veteran John Battelle created to pair Web sites with advertisers (Digg sparingly places ads in a narrow band at the top of the Web page). So far, Digg is breaking even on an estimated $3 million in annual revenue. Yet all the Valley hoopla gives the company a valuation of roughly $200 million, making Rose's stake worth a cool $60 million.

It's not as dot-com déjà vu as it sounds. YouTube, the enormously popular video site, posts similarly fledgling revenu but some experts say it could easily fetch $500 million. Wh more, Digg registered users have been doubling every th months. As such, Digg is attempting to follow the path l out by Google Inc. and now being adopted by many Web companies: focus on building a user community, and the will follow. "It's one of those things where we know we co put crazy ads all over the site and clutter it up, but we d want to do that," says Rose. "We have a clear path toward coming a profitable company, and we're fully funded. We d have to worry about it now, as long as we keep hitting numbers."

So far, Digg has succeeded. But success has also brou copycats and stress. A rumored $40 million offer from Yah Inc. surfaced in January, which Yahoo denied. Two weeks be the Digg 3 release, AOL launched a rival under the old Netsc brand. (It was headed up by former Silicon Alley superstar son M. Calcanis, owner of Weblogs, who early on offered R an investment in Digg and an option to buy it for $5 mill That would have left Rose with no control. Forget it.) On 18, AOL tried to lure Digg's top 50 contributors with $1,00 month to switch to its site, which led Rose to rant on his we ly podcast that Calcanis and AOL were trying to "squash Dig The corporate giant's failure to gain inroads so far shows t simply copying Digg won't work. It also spells out why Old dia types are so afraid of being eaten alive by the creative struction these young new players are delivering. The barr to entry are now so low that all it takes is a laptop and a $5 month Internet hookup to make a kid the next mogul.

Rose hints that there's going to be more to Digg than just mocratizing the news. In six months, he says, as he polishes a Belgian beer at Fly Bar in San Francisco a week after launch, the site will unveil "some really cool stuff." He's be ing as though he's talking about a new girl, and it's all he

The Bad Boy
Mark Zuckerberg

HIS COMPANY Facebook.com is a social networking phenom for the college crowd at thousands of schools across the country. The classier alternative to MySpace.

HIS BACKGROUND Zuckerberg, now 22, created the site in his Harvard dorm room to rate student attractiveness. It landed him in the dean's office. He reworked it to connect with classmates.

GEEK CRED Facebook is now the seventh-most-popular site on the Net. VCs once camped outside Zuckerberg's office. At dinners, Zuckerberg couldn't order wine, but he could order around the money men. Fencing and Latin in boarding school. Once he had a business card that read: "I'm CEO...Bitch." Zuck, as he's known, says it was a joke.

CHALLENGE Translating college success to high school and post-grad scenes and proving it's worth more than nearly any other Web 2.0 site.

FUNDING Some $38 million to date with terms that have become Web 2.0 lore: Zuck negotiated a steep $100 million valuation and a clause that left him in charge as long as he wants. In the second round, that valuation soared to $500 million.

minences Grises
lax Levchin
ames Hong

IEIR COMPANIES Levchin founded PayPal in 1998 d sold it to eBay in 2002 for $1.5 billion. Now he runs lide Slide.com. Hong co-founded Hot or Not in 2000 and eschewed venture money, bootstrapping his way to several million a year in profits from his site.

)W THEY MET Levchin had sold PayPal, and Hong d stepped back from his day-to-day role at Hot or Not. ey met at venture firm Sequoia Capital and struck up onversation that led to a tight friendship. Between m, they know almost everyone in the Web scene.

HAT THEY'RE DOING NOW Levchin, 31, has rted slide.com, which scours the Web for whatever a scriber requests and delivers it in slide show form. ng, 32, still works for Hot or Not but spends more of time funding or advising his friends' companies.

VESTING PHILOSOPHIES Levchin rewdly evaluates deals, investing only in handful he really believes in, like p.com. Hong, who makes Levchin fly ach instead of chartering private planes, es his wealth like a lottery: He backs his nds, and if he makes money, great.

HOT or NOT

EEK CRED Levchin built a spreadsheet of his lfriends' bra sizes to see how his taste was changing. 15, Hong was caught by the FBI for using Net chnology to scam phone companies. The G-men lled his dad and issued a stern warning.

hot to blurt out what all that cool stuff is. "Why would you unless you feel you've played your hand?" he asks.

he thought of selling all or even a large piece of his venture gs back some bad memories. Rose and all the other geeks w someone from the last boom who was worth millions one nth, only to move into his parents' basement the next. In- d, Valley-wide, guys like Rose, his entourage of buddies, and ny others are haunted by the years when the weekly rooftop ties died, the traffic thinned, and no one needed restaurant ervations. This time around, the entrepreneurs worry that, hin a moment, the money—and their projects—could vanish.

ock Star Status

T FOR NOW, Rose is the "It" boy among a new wave of repreneurs running the hottest of the top 100 Web 2.0 npanies sprinkled around the Bay Area. Together, this work of mostly Valley boys—Six Apart Ltd. co-founder na Trott is a rare female among them—fill SF bars like A1 and Wish and Cav and parties at their sparsely fur- hed lofts.

Rose's social stock has climbed,too. He has more than 000 friends on MySpace. He was a runner-up in blog VleyWag's "Hottest Guy in the Valley" contest (think m Cruise's doughier little brother), and he co-hosts a hot ekly video podcast called *Diggnation*. It's like a techie ver- n of the *Saturday Night Live* skit "Wayne's World." He l Alex Albrecht, a former TechTV co-host, sit on a couch, drink beer, say "dude" a lot, and talk about the biggest stories that week. At a party for the 50th show, Rose was mobbed by fans and even photographed signing a pretty brunette's cleavage. The snapshot was posted on Flickr the next day, prompting one viewer to comment: "When did they become rock stars?"

Clearly much has changed since 1999, and Rose and his fellow wealth punks have little in common with the sharp-talking MBAs in crisp khakis and blue button-downs who rushed the Valley as the NASDAQ climbed. In the late 1990s, entrepreneurs were the supplicants, and Sand Hill Road, dotted with venture-capital firms, was the mecca. Dot-commers relied on VCs for the millions needed to buy hardware, rent servers, hire designers, and advertise like crazy to bring in the eyeballs. For their big stakes of, say, $15 million for 20% of a company, venture capitalists received board seats,

More on Valley Boys, Only at Businessweek.com

The Geek Lowdown: An extended slide show on all the young entrepreneurs turning heads in the Valley

Listen In: Executive Editor John Byrne talks about the mini-mogul scene with Sarah Lacy and Jessi Hempel in a podcast interview

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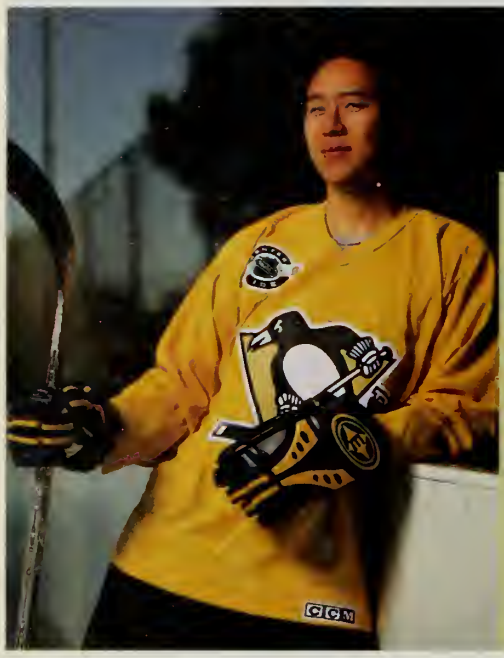
control of the management levers, and most of the equity.

Now, it's more like: Maybe we'll let you throw a few bucks our way—if you get it. Otherwise, get lost. That's possible because the cost of jump-starting a good idea has plummeted. At the same time, the sources of money have multiplied, swirling in from new VC shops, angel investors, and strategic partners galore. The awash-in-capital environment has flipped the power dynamic. Sure, they'll take money from the "sweater vests," as Adelson calls the VCs, but they'll do it on their own terms. "It's a good time now for the entrepreneur," says John Freeman, a professor at University of California at Berkeley's Haas School of Business. "There are lots of different pots of money. It gives them the ability to modify when they take it, [and] how much they take, and leaves them with more control."

Who are some of the new geek elite? Besides Rose, there's his pal and Wall Street transplant Joshua Schachter, who recently sold Del.icio.us, a Web site to exchange favorite links, to Yahoo for an estimated $31 million; gaming whiz kid Dennis Fong, a.k.a. Thresh, co-founder of gaming company Xfire, which sold to Viacom Inc. in April for $102 million; Mark Zuckerberg, who started the social networking site Facebook in college; and Jeremy Stoppelman and Russel Simmons, co-founders of Yelp.com, a consumer review site. The elder statesmen of th group are Hot or Not founder James Hong and his best frien Max Levchin, who sold his company PayPal to eBay Inc. for $1 billion at 26 and is now engrossed in Slide.com, a startup th delivers images to computers in a slick slide show format.

Digg is emblematic of the ethos of Web 2.0, new consum and media sites revolving around social networking and do-i yourself services. Others include YouTube, which serves u some 100 million requested videos a day, rivaling the audien of NBC. Then there's Facebook, where the college crowd pra



Game Boy

Dennis Fong, a.k.a. "Thresh"

HIS COMPANY Xfire, a site where gamers face off via an instant-messaging window; designed not to crash or be disruptive to power-consuming online games. It sold to Viacom for $102 million in April.

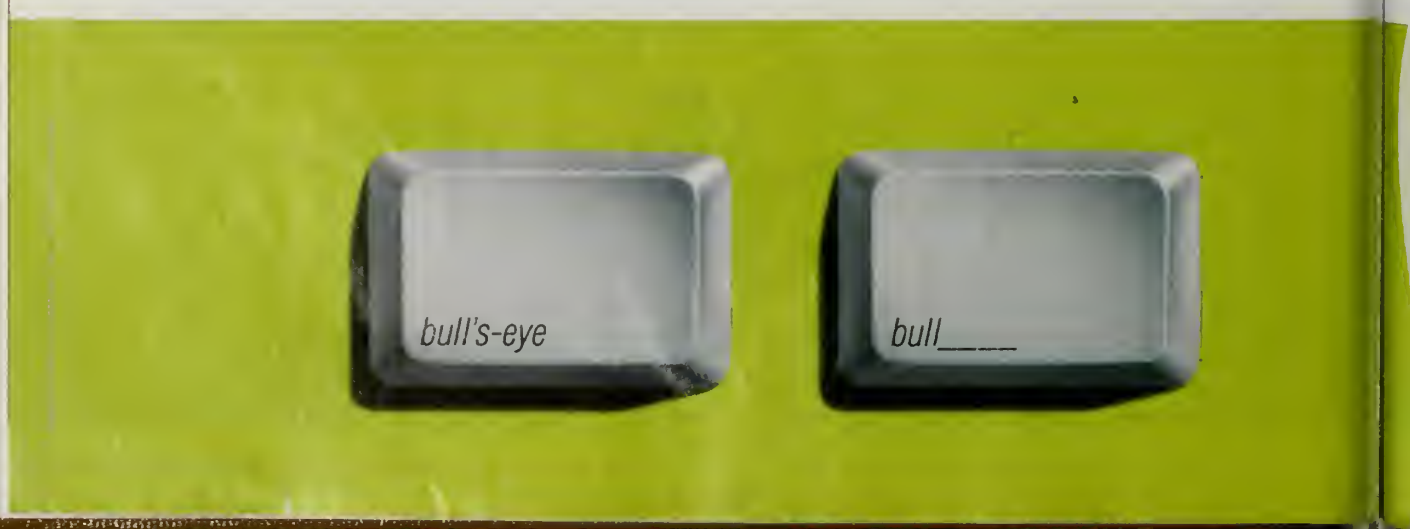
GEEK CRED Achieved superhero status in high school as one of the world's first professional gamers. His spoils: six-figure endorsement deals and a tricked-out Ferrari. Started Gamers.com, a site with gaming tips and techniques, with his brother in the mid-1990s. He took venture capital in 2000 and was shoved aside for a "grown-up" CEO who Fong says wrecked the company. That has led to the 29-year-old's "no-reckless-funding, please" stance with Xfire.

CHALLENGE Viacom paid more than 10 times the company's revenues, twice the MySpace multiple. But will the suits stomp out Xfire's street chic?

FUNDING Raised $11 million from Granite Global Ventures, Draper Fisher Jurveston, and New Enterprise Associates, though most was never spent.

tically lives. The average gamer on Xfire spends an astounding 91 hours a month on the site—i like a part-time job. As a result, superhigh valuations are aga coming out of the Valley. In a world in which Facebook tur down $600 million deals, the $580 million that Rupert Mu doch's News Corp. shelled out for MySpace.com in July, 200 is widely considered to be a steal.

Those in the know believe that Digg could become a ne kind of clearinghouse for news and that its interactive co munity concept could snowball. That could be a jackpot f Rose, who owns 30% to 40% of the company (he won't spe fy)—a massive stake for a founder in a world in which i



tors routinely demand up to 20% with e ry outlay. But it's still only paper w lth, which he and many others have le ned can evaporate. "I was here in 2)0," he recalls in an instant message.

t was just two years ago that Rose was th host of an obscure cable show, *T Screen Savers*, on a low-rent c nnel called TechTV. One day, he w s at lunch with Apple Computer h . founder Steve Wozniak, a fa- ite interview subject. Woz was in a ep riff about the glamour of Ap- s garage days, and Rose realized he was ous of Woz's place in Valley history. This g has actually done things, Rose remem- s thinking, while I'm, like, a visual ste- n grapher. That night, Rose returned to his fi -person Santa Monica house, head d vn, and plopped in front of his computer. L e every other night, he explored the back c es of the Internet, scavenging for hidden g sip and unearthed news that eluded n st mainstream editors. They were all so c eless, Rose was thinking. And then it oc- c red to him: Oh my God. I could do this S. MUCH. BETTER.

The Wall Street Transplant
Josh Schachter

HIS COMPANY Del.ici.ous, a Web site that allows users to exchange favorite links that he perfected before quitting Morgan Stanley to run it full-time. Accepted his first and only round of funding in March, 2005. After selling to Yahoo! in December for a reported $31 million, he now runs the site from cubicle No. 4434 at Yahoo's Santa Clara (Calif.) campus.

GEEK CRED After getting a degree in electrical and computer engineering from Carnegie Mellon, Schachter defected to Wall Street. Following his workday, he coded for fun in his Upper West Side apartment. His wife, Anja, also a computer programmer, could beat *Halo 2* long before he could.

GOING CONCERN Did the 31-year-old sell too soon? Some say del.ici.ous could have been a reverse Google, sorting searches in order of what people care about, not what algorithms deem relevant.

FUNDING Marc Andreessen sent free servers via U.S. mail. One venture-capital round led by Union Square Ventures.

ottom-Up Media

ON, ROSE WAS blabbing about his idea to his girlfriend, his ds, his bartenders. This would be bottom-up media. Citizen rnalism. In the fall of 2004, Rose withdrew $1,000—nearly e-tenth of his life savings—and paid a freelance coder $12 an ur to mock up a Web page. He got a deal on server space over Web for $99 a month. Only one big expense was left: the main name. He tried Dig.com. *!@#! It was owned by Dis- . He offered the owners of digdig.com $500. They wouldn't l. Ouch. Finally he settled on Digg.com and forked out 200 to its owners. The site launched on Dec. 5, 2004.

Today, Rose is like one of those guys he used to interview. But and his ilk have their detractors. Some say Digg is just re- gitating news. Others accuse Web 2.0 entrepreneurs of try- to build businesses around little more than one cool feature. always in the Valley, say critics, the froth floweth over.

Rose is listening to his gut, he says. Digg arose out of his everyday life, just as Facebook and YouTube and Xfire did for their founders. During the boom, MBAs dreamed up stuff they thought could nab money. Today, the geeks insist they're looking at ways technology can fill the gaps in their own lives. Then they build those services and share them with their friends. Once something works, they start to dribble it out to the world. But nothing too fancy that needs money to get started.

So the VCs aren't so mighty this time. There's intense competition among funders for pieces of Web 2.0. Two decades ago, nearly 300 VC firms invested in high tech. Last year, that number soared to 866 in the U.S. Meanwhile, deal sizes for Internet companies are contracting, even as valuations for those deals almost doubled from 2004 to 2005 and are rising still. That means investors are forced to take smaller stakes in Web deals, while entrepreneurs holding on to more. Money is also coming from legends like Marc Andreessen of Netscape fame, who's backing Web 2.0 projects, as are rich friends Levchin and Hong. "Until capital becomes important again, venture capitalists are screwed," says

SHARE YOUR THOUGHTS.

Sun believes sharing is the way to create better ideas. That's why we've teamed up with *BusinessWeek* to offer you an opportunity to share your comments. Join the conversation about this week's Cover Story at businessweek.com/coverstory.

Sun microsystems share

Andrew Anker, a former VC at August Capital in Menlo Park, Calif., who decamped in 2003 for blogging startup Six Apart.

Rose grew up in Las Vegas. His father is an accountant, and his mom "just chills," he says. They lived in a three-bedroom house on a cul-de-sac. Standard middle-class America. His computer love affair drew scorn from schoolkids so Rose transferred to a public vo-tech in 1993 to study computers and animation. "It was a chance to be with other nerds," he says.

In 1999 he dropped out of the University of Las Vegas to join the action in Silicon Valley, where he took coding jobs for dot-coms. That led to his gig as the TechTV host, which transferred him to Los Angeles in 2003. But Rose was bored. He hated L.A. If it hadn't been for his friendship with Adelson, he might never have pursued the Digg idea. The two met when Rose interviewed Adelson, 35, founder and chief technology officer of data center company Equinex, on TechTV in 2003. Here was another guy actually doing something. Rose and Adelson quickly hit it off. Adelson played the grown-up, a role he still relishes, saying things like, "Kevin, you're 29 now, you need to stop wearing your pants lower than your boxers" (advice Rose still ignores). But he believed in Digg from the beginning.

The Ladies' Men
Russel Simmons Jeremy Stoppelman

THEIR COMPANY Yelp.com is stealing a slice of the local ad market in various cities. On the site, people review everything from their doctors to hot new clubs. Zagat meets Google meets Yellow Pages. Users stay rabidly dedicated, thanks to Yelp's sceney, lavish parties, where pretty girls regularly show up.

GEEK CRED Simmons, 27 (left), graduated from the prestigious Illinois Mathematics & Science Academy at 16. Back in 1998 he was the first engineer PayPal hired. Stoppelman, 28, also a PayPal alum, is the token Harvard Business School dropout of the crew.

SUCCESS TO DATE It's a go-to site for hip, twentysomething SFers that is now expanding in New York, Boston, Chicago, and Los Angeles. But can the formula work in other cities?

FUNDING Yelp raised $1 million from PayPal founder Max Levchin in 2003 and $5 million from Bessemer Venture Partners in 2005.

Forget Portals

IN FEBRUARY, 2005, Rose cashed Digg's first investor check. It was for $50,000 and came from a friend, Chris Hoar, who had founded Textamerica, a site that enables you to post cell-phone photos to your blog. When Rose was desperate for servers, Hoar cut him a check on the spot. Digg didn't even have a company bank account yet, so Adelson walked Rose through the accounting and helped him drum up the next round, which w several hundred thousand dollars in investments from angel i vestors, including Andreessen and Reid Hoffman, CEO of soci networking site LinkedIn.com Corp.

Rose asked Adelson to sign on as chief executive. Adelso had been burned during the last boom, when his net wor dwindled from a high of $55 million, but he decided to take t job, even though it would mean commuting between Ne York, where his wife and three kids live, and San Francisc There was something about Rose: He reminded Adelson of h younger, single self.

By spring 2005, t venture set had caug on that somethi was happening Digg. Adelson w fielding a call per we begging for a meetin but he kept stallin He wanted Digg to g more traction, to w until they really nee ed the money. "I do want to be someone ticket into a market Adelson says. Whe

they started talki with VCs last Augu Adelson recalls, a fe asked about Digg plans to convert its si into the next Yahoo Google. "They are st back in the 1998 beli system that it's about portals," Adelson says, laughing. "Grow up, man."

At an obscure office complex in San Mateo in August, 200 the reception was different. Greylock Partners is a storied V firm with many home runs to its credit, but few dot-con among them. Yet Greylock partner David Sze seemed to d Digg. He himself was a member of the Digg Army. He unde stood Rose's of-the-people vision. "There were not a lot of i between kind of guys," Rose says. "David got it, and mo everyone else didn't."

Then Sze, 40, stunned them. Rose and Adelson were seekir only $1 million or $2 million, pocket change to most Silic Valley firms and hardly worth their time; VC firms usually ma big bets to win big stakes. What firm has the resources to ke an eye on 100 companies? Funders had been trying to persua them to take $5 million, even $10 million, but Adelson sto firm. Sze agreed they didn't need it and got his his partnersh to change the rules and green-light the small deal: $2.5 millio divided between Greylock and another firm, Omidyar Networ the venture fund of eBay founder Pierre Omidyar.

Digg was finally flush with enough cash to pay salaries, re an office, and keep employees in standard startup snacks li

izzlers and Vitamin Water. Adelson did the hiring and man-ed the business, while Rose worked on Version 3.0. On trips me to Las Vegas or to see friends in L.A., Rose dreamed up at st one new feature per trip, like the Digg "stack," which vi-ally shows users how stories are being ranked in real time, d a module for tracking friends' activity on the site.

But the consumer Web is still a crapshoot. As early social tworking sites like Friendster learned the hard way, audi-ces can be fickle. "It's kind of like the entertainment busi-ss," says Berkeley's Freeman. "If it hits, it's big."

So far, Digg's traffic just keeps growing. And Rose is picking up a bit of swagger. His shyness is fading, and his wardrobe has gotten a hipster upgrade. Girls on MySpace swarm him. But the pain of losing his girlfriend isn't gone, and he says that no matter what happens with Digg, he won't put business first again.

The tech bust notwithstanding, the Valley is still the only place on earth where geeks with good ideas can become celebrities overnight. But wannabes be warned: As nearly everyone found out six years ago, the fall from rock star to pariah can be just as quick—and not nearly as much fun.

Internet Chic

Designer Jeans Meet Deep Pockets

Back in December, 1999, just as all the Silicon Alley launch parties were going cash bar and venture capital was scarce, Dany Levy started an Internet company. Insane. Levy was a 28-year-old editor on a prototype for a new Condé Nast magazine called *Lucky*, but the beauty business was not her thing. And she had seen people like financial guru James Cramer win scores of dedicated readers with his daily Wall Street Web site, TheStreet.com. Surely as many women were addicted to fashion. Why not give them a daily dose of all things trendy via an insidery e-mail newsletter? She would hook them with Marc Jacobs sample sale listings and plugs for the latest $200 jeans, then keep them coming with *Sex and the City*-esque fashion tips. She'd call it DailyCandy.com.

Today DailyCandy is proof that geeks, albeit stylish ones in Levi's low-rise jeans and drugstore flip-flops, are alive and well in New York's Silicon Alley. More than 1.4 million subscribers gobble up daily dispatches in nine cities across the U.S., plus London. New franchises include a kids' edition, a special deals edition, and one on travel. The site got so hot that it attracted several potential funders and in 2003 accepted an investment from Pilot Group, headed by former AOLer Robert W. Pittman. Last summer, Pilot put DailyCandy on the block for $100 million, and pundits proclaimed the valuation evidence of another bubble. But instead of selling, the site took a second round of funding, which helped push its value to an estimated $130 million. This year's revenues are projected to be nearly $19 million, more than double those of 2005.

LEVY Fashion tips, sale news, all things hot—and a $130 million valuation

Not bad for a startup born just as the NASDAQ flamed out. Says Levy: "I didn't really even know." So focused was she on her idea that she didn't waste energy drumming up venture capital or worrying about Aeron chairs and dot-com swag. Instead, she withdrew the nest egg she had put aside for an MBA. Three days after the New Year, clad in black drawstring pajama bottoms and a white tank, she sat down to work in the kitchen alcove of her West Village one-bedroom. A postcard of Dustin Hoffman from the film *Midnight Cowboy* that hung above her desk read: "They hustled to get here."

DailyCandy owes its success to its passionate audience. The typical reader is a 29-year-old college-educated woman, usually an early adopter and opinion leader. That translates into value for marketers, who pay thousands of dollars to advertise on DailyCandy e-mails to subscribers.

In the beginning, Levy plugged DailyCandy relentlessly. She collected e-mail addresses of friends, friends of friends, and the occasional stranger. She stood in Penn Station handing out postcards (where she ran into a former classmate from Brown University, who asked: "This is what you're doing now?"). She haggled with publicists she knew from her old life as a *New York Magazine* staff writer. And she approached friends, saying: "Can I ask you about this idea I have?" Then she would whip out a nondisclosure agreement to keep the chat confidential.

On Mar. 6, 2000, Levy debuted with a heads-up that Zagat Survey was starting a nightlife guide, followed by a plug for a J. Crew bikini you could get a tan through. Soon subscribers doubled. With help from two angel investors, Levy got an office and hired writers. In fall, 2001, DailyCandy became profitable. By mid-2003, Levy realized the site couldn't grow without help.

That's when Pittman's Pilot Group came in. Levy calls it the right deal. "There's money, and there's good money," she says. "If you're going to accept an investment, you want to take it from someone you think is going to add something." So far the investment has allowed Levy to include more cities. Next up: Miami.

—Jessi Hempel

WALL STREET'S NEW LOVE AFFAIR

BY EMILY THORNTON AND ADAM ASTON

Why some of the world's smartest investors are betting billions on clean energy

YOU SENSE IT FROM THE WAITING LISTS FOR Toyota Priuses. You see it on the faces of the solar-energy stalwarts who are suddenly being showered with attention. You read about it constantly in newspapers and magazines. And you hear it on TV and even at the movies. Warnings about global warming grow more dire by the day: Experts say Manhattan, Washington, and San Francisco will eventually be under water unless people start filling their tanks with corn squeezings and bolting solar panels to their roofs.

As troubling as the predictions are, even more urgent problems are weighing on the American psyche these days—namely the price of oil, which is surging past $75 a barrel, and the deteriorating Middle East situation. In liberal and conservative circles alike, energy independence is becoming a national imperative, and renewable energy is attracting an unprecedented array of groups. "We're seeing an alignment of the environmental interests, automakers, the agricultural industry, the security and energy-independence proponents, even the evangelicals," says billionaire venture capitalist L. John Doerr. "When did all those [interests] come together before?"

You know a cultural movement is real when the money men get on board. In just the past year a broad swath of financiers—venture capitalists, hedge funds, investment banks, public pension funds, and even stodgy insurers—have begun sinking billions of dollars into producers of ethanol, fuel cell superbatteries, microscopic bugs that turn glucose into plastic, environmentally friendly pesticides, anything that might tap into the green craze. Saving the planet, protecting America, doing God's work, cynically exploiting a feel-good trend—call it what you will. Wall Street sees money to be made. When John V. Veech, a managing director at Lehman Brothers Inc., showed up at a renewable energy conference in June, he was amazed to see that it was standing room only. "If you went five years ago you'd see a lot of ponytails," he says. "Now these conferences are packed with suits."

Make no mistake: The U.S. is not about to resemble an eco-utopia anytime soon. For all the happy talk about clean energy and green technology since the 1970s, people just haven't adopted the gadgets and concoctions written about in science magazines. The government has provided billions in subsidies over the decades for ethanol, wind, and solar technologies to help make them more economically competitive—without much success. In 1975 renewable energy accounted for 6.6% of total energy consumption. By 2005 that figure had slipped to 6.1%. It would take decades more and tens of trillions of dollars to produce the countless windmills, solar panels, geothermal plants, and power-generating dams needed to mothball the nation's

GREEN BIZ

coal- and gas-fired electric plants. And production of biofuels such as ethanol and biodiesel would need to soar from 325,000 barrels a day to nearly 16.5 million to replace conventional road fuels. Getting there quickly would be "physically impossible," says Steven C. Taub, director of emerging-generation technologies at Cambridge Energy Research Associates, a firm that advises big oil companies and utilities.

Bigger Piece of the Pie

WALL STREET ISN'T BANKING ON a radically different future, though. It's merely betting that wind, solar, biofuels, and the rest will make up some bigger portion of the nation's $1.6 trillion energy market—enough to give clean-energy investing cred as part of a diversified portfolio. Their confidence is bolstered by the federal and state clean-energy quotas that have appeared virtually overnight. Already, 22 states have ordered utilities to obtain as much as 33% of their electricity from renewable sources within the next 10 years. Others are likely to follow. And given the green-is-good mood these days, it would take a budgetary calamity to prompt politicians to yank clean-energy subsidies. They'll likely be around for a while.

Even modest gains at the margins could add up to real money for investors. Let's look at some small slices of the energy market. Cambridge Energy, hardly a haven for green warriors, expects demand for ethanol and biodiesel for cars and trucks to more than double, to 6% of all road fuels, in the next four years—a $28.4 billion opportunity. It expects demand for power from wind, sun, geothermal heat, biomass, and water to rise from 2.5% of the nation's electricity to 3.4%. That translates to as much as $10 billion in new revenues for clean power producers by 2010. And these are baseline assumptions over the short run. If the technologies gestating today were to make, say, plant-derived jet fuel cost-competitive, the opportunities could increase by orders of magnitude.

Wall Street is champing at the bit to provide capital. Last year, $17 billion poured into clean-energy projects in the U.S.—89% more than in 2004, estimates researcher New Energy Finance Ltd. Worldwide, the $49 billion collected in 2005 was up 62% fro 2004. Interest in this stuff is "out of control," says Credit S isse Group banker Paul T. Ho as he sifts through stacks of p pers on his desk for potential initial public offerings of cor panies that produce fuel from corn, restaurant grease, prai grasses, orange peels, and municipal waste. He says the aren't enough suitable opportunities out there for all the r quests he's fielding from well-heeled investors.

There is a downside to the flood of newcomers rushing i They're sending valuations higher, making good deals mo difficult to find. And lavishing capital on technologies that ha been stalled for three decades will surely trigger painful disl cations. For example, producers of today's leading solar pane which use costly silicon wafers, might soon be threatened companies like Phoenix-based First Solar Inc., which says will make power from the sun as affordable as regular ele tricity within four years by using cheaper materials, such

LUSH AND GROWING FAST

Follow the Money

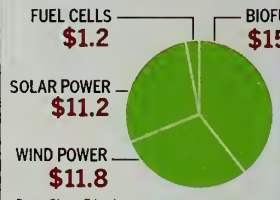
Around the globe, capital rushing into clean-energy ventures jumped 62% in 2005

2004	2005
30	48.9
Billion	Billion

Data: New Energy Finance

Global Clean Energy Sales

2005 TOTAL: $39.9 BILLION



Data: Clean Edge Inc.

High Risk, High Return

Some clean-energy companies—but not all—have had dazzling initial public offerings

COMPANY	DESCRIPTION	DATE OF IPO	RETURN FROM IPO
SunPower	Maker of solar electric-power products	11/16/2005	74.6%
Suntech Power Holdings	Chinese maker of solar cells and panels	12/13/05	72.3
VeraSun Energy	U.S. ethanol producer	6/13/06	6.3
Aventine Renewable Energy	U.S. ethanol producer and distributor	6/28/06	-30.1

AVERAGE RETURN: 30.8%

Data: Thomson Financi

Green Giants

*COURTESY OF CLEANTECH CAPITAL GROUP

Data: Bloomberg Financial Markets

Picking Favorites

Imagine if the government had subsidized clean energy as it has subsidized traditional energy...

TRADITIONAL ENERGY*	ANNUAL SUBSIDY (BILLIONS)	CLEAN ENERGY	ANNUAL SUBSIDY (BILLIONS)
Oil and gas	$38.9	Ethanol	$4.3
Coal	7.8	Other renewables	5.6
Fossil fuel, mixed	2.4	Conservation	1.6
TOTAL	$49.1	TOTAL	$11.5

*Excludes nuclear energy, which receives $9.2 billion annually

Data: EarthTrack.net

ss, rather than pricey silicon. A showdown is also coming
the ethanol business between conventional corn-kernel
kers and those who plan to use more parts of the corn plant
well as switchgrass and even municipal waste (page 56).
But look closely at how the market is treating clean-energy
cks, and you'll see why the moneyed elite are clamoring to
in. Since late 2003, as oil prices have shot up, stocks that
ke up Cleantech Capital Group's Cleantech In-
have jumped 67%, vs. the Standard & Poor's
0-stock index's 31%. A spate of initial public of-
ings by solar and ethanol companies in the U.S.
e delivered returns of 31% on average since go-
public within the past year. And the combined
rket capitalization of solar companies worldwide
soared thirty-eightfold, to $27 billion in the
st 12 months, estimates Credit Suisse.
Given the euphoria, it's tempting to compare
en investing with the Internet boom of the
0s. But there are important differences. By
5, when Netscape went public, the World Wide
b already existed. In contrast, truly transforma-
e clean-energy technologies haven't even been created yet. Think of green investing in 2006 like technology investing circa 1976, when computer hardware was just starting to be introduced. Bet on the next Intel, and the sky's the limit.

Of course, the green gains of the past few years are directly related to the price of oil, which has doubled since 2003. Oil remains the main lens through which all energy is viewed, and it takes high prices to stir demand for alternatives. Some economists are forecasting $100 a barrel for the foreseeable future. Others say it would take only the briefest of global recessions to push the price of oil below $40. Certainly the big payoffs for alternative energy would vanish in a second if oil prices were to plummet suddenly.

But the Street is focusing on the vast gray area that exists between these extreme scenarios, wherein oil prices remain high enough to keep renewable energy viable and profitable. With oil at $75 a barrel, it costs half as much to produce a gallon of ethanol as a gallon of gasoline. Right now it runs about 6¢ to generate a kilowatt hour of electricity power from wind, vs. a national average of 8¢ for electricity from coal or natural gas. To bet on renewable energy is to bet that those spreads won't go away.

Newly Convinced

EVEN EXPERIENCED OIL PROS are putting up money. David M. Leuschen, 55, is a founder of private-equity firm Riverstone, which co-manages about $7 billion with the Carlyle Group and invests in all types of energy, including coal-fired plants. It also has a $685 million renewable-energy fund invested in solar power, geothermal, and ethanol plants. Leuschen is a tall, fourth-generation Montanan who operates more than 100,000 acres of ranches, mostly near Yellowstone National Park. He's no radical greenie; in fact, he doesn't like to discuss global warming. That's "a debate for scientists," he says in his office overlooking New York's Central Park.

Like many others who are financing and investing in green technologies, Leuschen built his career largely on his expertise in the areas of energy that drive environmentalists nuts. In 1999, while a banker at Goldman Sachs, he helped advise Mobil on its $81 billion merger with Exxon. He left Goldman in 2000 to co-found Riverstone. When some large public pension funds approached him about starting a renewable-energy fund two years ago, Leuschen hesitated, thinking alternative power couldn't deliver decent returns. "Our first obligation to our investors is to make money, and I wouldn't have initially considered renewable energy the best place to make money," he says.

Now he thinks otherwise. Leuschen isn't turning his back on coal, which generates more than half the U.S. electricity supply. But his company,

Cost to produce a gallon of...

$1.30
Ethanol

$2.75
Gasoline*

*Assuming $75/barrel of oil
Data: Credit Suisse

A FEW WHO THINK THE MARKET IS RIPE

Where some business titans are placing their bets

together with Florida Power & Light Co., owns one of the world's largest solar-power plants, in California's Mojave Desert. Investors in Riverstone's renewable-energy fund have been told to expect annual returns of 15% or so and perhaps much more, based largely on the fact that most alternative-energy producers are able to enter into long-term contracts with utilities, some lasting 15 to 20 years.

Investment banks are making long-term bets, too. Instead of taking green companies public and collecting the easy underwriting fees, Goldman is choosing to own companies outright and keep the profits for itself. It's putting $1 billion into everything from wind power to ventures that might one day produce ethanol profitably out of waste. JPMorgan Chase & Co. has invested in 17 wind farms and hopes to get into solar and geothermal plants soon. "The wind business has been growing at 25% a year," says John M. Eber, managing director for energy investments at JPMorgan Chase in Chicago. "We're responding to today's market needs."

What's striking about green investing is the sheer variety of players jumping in. Huge public pension funds CalPERS and CalSTRS together have committed more than $1 billion to green investments. Multibillion-dollar hedge fund groups like S.A.C. Capital Advisors and D.E. Shaw & Co. have invested in and financed producers of geothermal energy, ethanol, and wind power. Even insurer American International Group plans to steer private-equity investments to projects that help cut greenhouse gas emissions. And venture capitalists earmarked some $917 million for clean-energy startups last year, almost double the amount in 2003, according to research firm Clean Edge Inc. "Almost every venture firm now either has a clean-tech effort or a separate clean-tech fund or a few clean-tech partners and at least one clean-tech investment," says venture capitalist Bill Gross, who invested in a slew of dot-coms and is now focusing on solar power at a company called Energy Innovations Inc.

Warren Buffett, CEO of Berkshire Hathaway, which owns MidAmerican Energy, the nation's leading utility in wind energy. It has invested $385 million to build wind-power plants.

At GE, CEO **Je Immelt** is bett that green tecl will fuel the ne century of gro GE sold $10 bi worth of clean gear last year. plans to put $ into clean-ene ventures by 2(

(PHOTOS OF FACES, L TO R) NICHOLAS ROBERTS/AFP/GETTY IMAGES; BRADLEY C. BOWER/BLOOMBERG; DANIEL ACKER/BLOOMBERG NEWS; CHARLES CROWELL/BLOOMBERG NEWS; PAUL SPINELLI/GETTY IMAGES; ANDY FREEBERG/BLOOMBERG NEWS; ETHAN MILLER/GETTY IMAGES; JUSTIN SULLIVAN/GETTY IMAGES

Once Burned, Not Shy

POTENTIALLY LUSH PROFITS are luring business luminaries, too, including Berkshire Hathaway's Warren Buffett, Microsoft's Bill Gates, Google's Larry Page and Sergey Brin, and Sun Microsystems co-founder Vinod Khosla. Such captains of industry as Virgin Group CEO Richard Branson and General Electric CEO Jeffrey Immelt are plowing hundreds of millions, and in some cases billions, into green ventures.

Each green banker, research analyst, and investor tells the story of an "aha" moment. For Brion Tanous, an analyst at investment bank Merriman Curhan Ford & Co., it came when he drank a glass of clean water directly from the tailpipe of a Honda fuel-cell car on display at an auto industry seminar. "Soon the question won't be whether you want a fuel-cell car," he says. "It'll be, what color do you want?"

John Doerr, a longtime partner at VC firm Kleiner Perkins Caufield & Byers who supplied startup funds to such N Economy giants as Google, Intuit, and Sun Microsystems, turned on to eco investing in 2000, when Dean Kamen, cha man and founder of scooter maker Segway Inc., shared his sion for how traffic and pollution would overwhelm cities 2030. Doerr, now 55, told *Time* in 2001 that Segway wou reach $1 billion in revenues faster than any other company history. When sales didn't live up to the hype, Segway beca fodder for critics, as did Doerr's decision to fund the compa Today, Segway has just $9.4 million in sales, estimates searcher Dun & Bradstreet Corp. Segway declined to comm on the estimate.

But Doerr still thinks green. From 2001 through this ye Kleiner Perkins has quietly committed more than $100 milli to nine ventures involved in everything from coal gasificati to ethanol. One of them, Ion America Corp., is preparing launch later this year of fuel cells that supply electricity

…ents, the …ent arm of …oft Chairman …tes, has …d in Pacific …l, a public …y that is …g an ethanol …California.

Virgin Group CEO **Richard Branson** plans to invest up to $400 million in a biofuel plant. He is also investing in wind power and trains that run on biodiesel.

Microsoft co-founder **Paul Allen** has sunk $250,000 into Seattle's Imperium Renewables, which plans to supply 40% of the growing U.S. market for diesel fuel made from vegetable oil by 2009.

Vinod Khosla, co-founder of Sun Microsystems, is a biofuels evangelist. In the latest of a string of ethanol deals, Khosla Ventures and other investors are plowing $50 million into ethanol startup Altra.

Google co-founders **Larry Page** and **Sergey Brin** have invested in Palo Alto solar-energy startup NanoSolar.

…dings. And in February, Kleiner announced that it has earmarked at least $100 million of its new $600 million fund for …n investments.

…o Martin Tobias, a self-described "Republican tech-geek …ware venture capitalist," what's exciting is how the wave of …stment is drawing good ideas and top minds from univer…s and corporate research labs. "This money is transform… ideas that have sat on shelves for years," says Tobias, …se attention shifted to clean diesel after he cashed out of …ts at Microsoft and Loudeye.com. In 2005, when he walked …a former Seattle brewery that owner John Plaza bought …his life savings to make clean diesel, Tobias suddenly rec…ized the potential of renewable crops. Plaza was producing …ches of diesel fuel cooked from soybeans—and selling every …p as quickly as he could make it. Together with Paul Allen's …can Ventures and other top-tier VCs, Tobias plowed …million into the plant and joined the company, now named

Deeper into the Green

See a wind farm and learn how to invest in green companies on our TV show, *BusinessWeek Weekend*. Check local listings or go to businessweekweekend.com and type in your Zip Code to find when and where it airs in your area.

Meet Connecticut Treasurer Denise Nappier (right), who's confronting ExxonMobil on global warming.

Take a peek at the green ambitions of Virgin's globetrotting boss, Richard Branson.

In a Q&A, venture capitalist Bill Gross tells the story of how he became a solar entrepreneur.

BusinessWeek online

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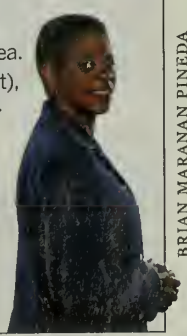


BRIAN MARANAN PINEDA

Imperium Renewables Inc., as chairman and CEO. Tobias is raising fresh funds to boost the company's production eightyfold.

The whole attitude toward green investing is shifting dramatically. Green "has become a mainstream business that's attracting mainstream investments," says Cambridge's Taub. When Mark Townsend Cox, 49, left his job as a portfolio manager at a family-owned investment firm in November, 2002, to start a hedge fund investing solely in clean-energy stocks, many prospective investors snickered or ignored him completely. "People would say, 'It's all science experiments' or 'No one makes any money from it' or 'There [aren't] enough publicly quoted companies to invest in,'" recalls Cox, who keeps a small solar cell in his bedroom that splits water into hydrogen and oxygen to remind him of how simple green technologies can be. With a scant $100,000, Cox launched the New Energy Fund on Dec. 30, 2004. He quickly set about scouring the globe for publicly traded companies involved in sustainable energy or green technology. He found more than 400 of them. His fund is up over 50% in 2006 and has more than $4 million in assets.

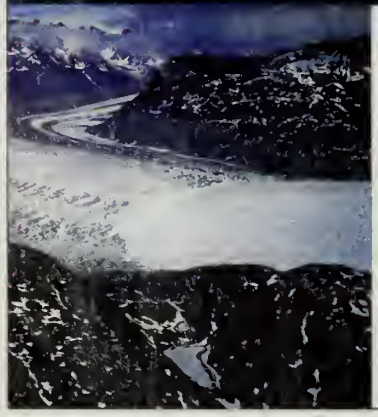
Filtering Down

LAST YEAR IT WAS ETHANOL that grabbed the attention of Paul Touradji, head of Touradji Capital Management, which manages about $1.7 billion. Touradji has been roaming cornfields, sugar mills, and oil refineries for nearly a decade. After working in the refining division at Mobil while in college, he was recruited to join the commodity team at Tiger Management in 1996 and became a protégé of former hedge fund titan Julian H. Robertson Jr. Touradji, who started his fund in January, 2005, perked up when he heard that some states were about to ban MTBE, a chemical added to gasoline to reduce emissions without hurting engine performance, because it had been found to contaminate groundwa Touradji reckoned that refiners would rush to ethanol, a cl er substitute that also fit the bill. By Touradji's calculati there would be an ethanol shortage even if supply zoomed bet on ethanol producers' stocks and bonds and made priv equity investments. By June, wholesale price of ethanol had pra cally doubled, to nearly $4 a gallo

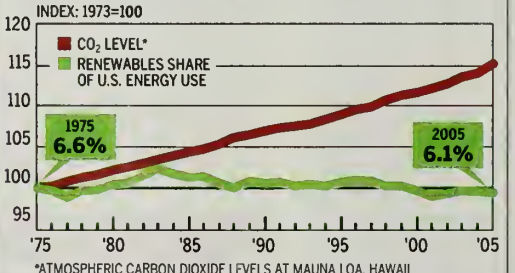
Wall Street's hunger for all thi green is filtering into businesses have been around for years, such the power-trading markets that En used to dominate. Because so m states have ordered utilities to dra big percentage of their electri from wind, solar, and water source coming years, traders must bundl green power as part of large tran tions with utilities. "If you don't h the ability to play in renewable e gies, large deals are nonstarters," Beau Taylor, global head of ene trading at JPMorgan Chase.

Markets for hedging products

Glacial Change



While greenhouse gases head skyward, renewable energy's role in the U.S. economy has barely budged. Wall Street is betting that won't continue



*ATMOSPHERIC CARBON DIOXIDE LEVELS AT MAUNA LOA, HAWAII

Data: Oak Ridge National Laboratory, Energy Information Administration, *BusinessWeek*

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percolating as new regulations on utilities stoke demand for emission rights and renewable-energy credits and hedge funds dive in to get a piece of the trading action. Already the global market for carbon emissions and related credits has ballooned from practically nil at the start of 2005 to more than $11.7 billion by yearend, according to energy consultant Point Carbon in Oslo, Norway. The market is on track to double this year. "Carbon has the potential to be the biggest trading market in the history of the world," says Andrew Ertel, president and CEO of trading firm Evolution Markets.

At Evolution's headquarters in White Plains, N.Y., contractors are busy setting up new desks and terminals for the firm to double its staff of 50—including a handful of ex-Enron energy traders—over the next year. Profitable since its first month in early 2000, Evolution has seen revenues compou by 50% a year. "We're saving the planet, one trade at a tim says Ertel.

Phenomenal growth, for sure. But it's no coincidence that prices have soared throughout the period, from $17 a barre 1999 to more than $75 now. If that upward spiral starts to wind, the whole green market could unwind with it, fr emissions to ethanol, solar power to superbatteries. Riv stone's Leuschen acknowledges this reality. "It's the umbr of high energy prices that's allowing us to do this," he says. oil went back to $10, I don't think we'd be talking about newable energy." But that's a risk Leuschen and others suddenly willing to take. ■

–With Justin Hibbard in San Mateo, C

THE GREAT CORN RUSH OF 2006

Ethanol profits are drawing in investors, but can the heyday last?

BY HEATHER GREEN

Facilities that can turn kernels into clean fuel seem to be sprouting up faster than the corn itself. There are 101 ethanol plants in existence, more than 41 new facilities and expansions in the works, and another 100 in the planning stages. At an average construction cost of $75 million, that's potentially $10.5 billion headed into ethanol.

Why the rush? Investors are wowed by the combination of short supply, surging demand, and government subsidies that top $2 billion annually. Already much of the nation's production capacity of 5 billion gallons is being soaked up by government mandates. Last spring, regulators ordered that ethanol replace MTBE, an environmentally suspect agent, as an emissions-cutting additive in the nation's gasoline. What's more, Washington is pushing for "renewable fuel standards," setting national sales targets for fuels such as E85, a mix of 85% ethanol and 15% gas.

The result: Wholesale ethanol prices now sit at just under $3, compared with around $2 a year ago. And since a gallon of ethanol costs just $1 to $1.30 to make and the government pays an additional 51¢ in subsidies for each gallon of ethanol, profits are booming. "These [plants] are money-printing machines," paying for themselves within a year, says Jason S. Grumet, executive director of the National Commission on Energy Policy, a bipartisan group of energy experts.

But don't break ground on your own backyard ethanol plant just yet. There are plenty of reasons for doubting that corn fuel is the answer to the nation's energy woes. Using today's production methods, it would take 85% of the U.S. corn acreage to produce enough to replace just 10% of gas demand, according to Alexander E. Farrell at the University of California, Berkeley. And since people and cows like to eat corn, too, rising demand could send prices soaring, making ethanol investments much less of a sure thing. Already, the Agriculture Dept. expects a bushel from this summer's harvest to fetch 24% more than last year.

What's more, since corn kernels must be cooked to make ethanol, producers are vulnerable to energy-price spikes. "Is money being thrown around? Yes. Is some of it unw money? Yes," says Brian Jennings, executiv director of the American Coalition for Ethar

Some investors are making moves to cu the risks. In Mead, Neb., E3 BioFuels is buil a plant smack next to a cattle feedlot. To fir distillers, the plant draws in methane captu from manure, cutting operating costs by 35 Even the waste is cheaper to dispose of: Th remnants of the corn kernels are fed to the cattle next door, rather than dried and shipp out. Overall, the plant will be 15 times more efficient than a traditional plant.

Investors such as Royal Dutch Shell, Gold Sachs, and venture capitalist Vinod Khosla a betting that bigger payoffs await in next-generation ethanol from so-called cellulosic sources. That's because cellulosic ethanol, made from corn stalks, saw grass, and even municipal waste, yields nearly seven times m fuel than corn kernels. The first cellulosic plants are expected to come online in 2009.

Still, it's costlier to break dow cellulose into ethanol than it is t break down kernels of corn. Giar such as Archer Daniels Midland Abengoa Bioenergy, and startup like Goldman-backed Iogen and Khosla's Celunol, are developing variety of approaches to crack th problem. And many of today's kernel-fed facilities are built to b convertible to cellulosic product once the kinks are worked out.

With all of the troubles on th near and distant horizons, etha can't be considered a panacea But more of it will soon find its into cars—and investors are su to go with the flow.

MONEYMAKER The fermenter at Iogen's Canadian ethanol plant

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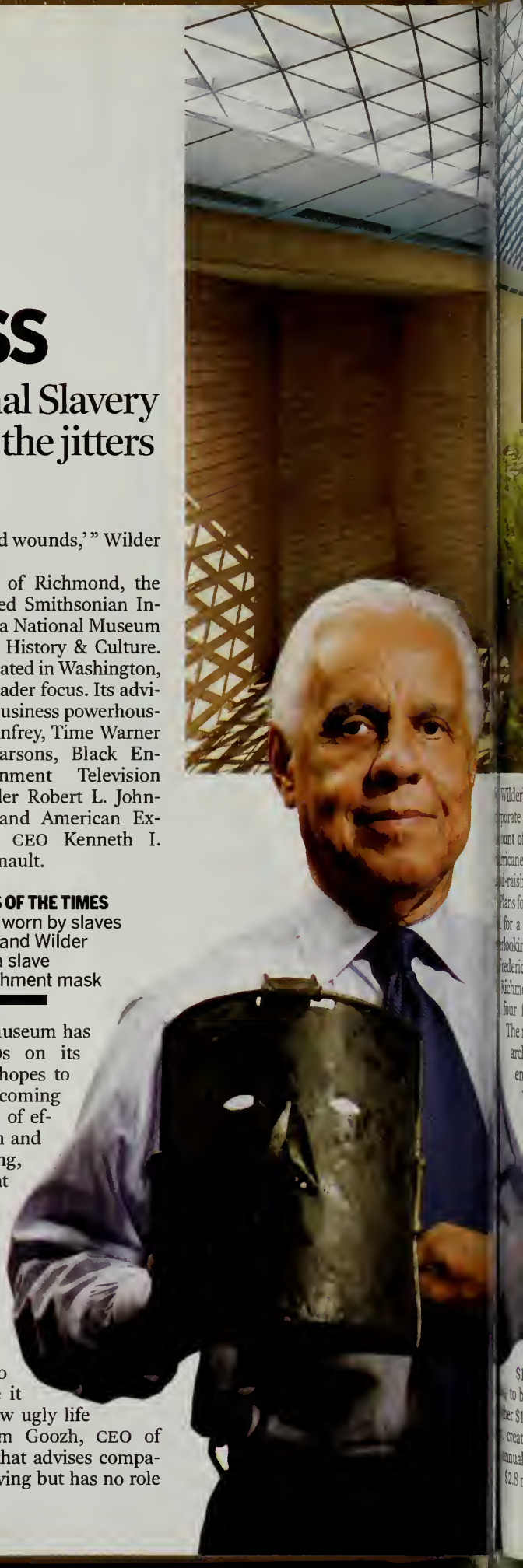
A Cause that Scares Business

The ugliness recalled by a National Slavery Museum gives corporate donors the jitters

BY RICHARD S. DUNHAM

THE IDEA FIRST CAME TO then-Virginia Governor L. Douglas Wilder in 1992 as he stood before the Door of No Return on Gorée Island, off the coast of Senegal, from which countless Africans were sent in shackles for enslavement in America. A year later, during a conference in Gabon, Wilder publicly disclosed his private obsession: creating a national museum of slavery. For the past 13 years he has been trying to transform his $200 million dream into a concrete-and-glass reality.

He has a long way to go. Wilder, the 75-year-old grandson of slaves and now the mayor of Richmond, the former Confederate capital, has the backing of such entertainment figures as Bill Cosby and Ben Vereen, who played Chicken George in the TV miniseries *Roots*, and eminent historians such as John Hope Franklin of Duke University. But to start a museum it's almost mandatory to have corporate money, and Wilder has discovered that many companies aren't eager to give to a cause tied to the country's most enduring sin.



SIGNS OF THE TIMES A tag worn by slaves (left) and Wilder with a slave punishment mask

"TOO SENSITIVE"

MUSEUM OFFICIALS SAY they have received $50 million in pledges or contributions from corporations and individuals, topped by Cosby's $1 million gift last year. Business benefactors include Wal-Mart, Wachovia Bank, Dominion Power, and Philip Morris. But others have hesitated to touch the topic. "They say: 'It's too sensitive. You're just trying to pull scabs off of old wounds,'" Wilder recounts.

Two hours north of Richmond, the government-supported Smithsonian Institution is planning a National Museum of African American History & Culture. That project, to be located in Washington, will have a much broader focus. Its advisory board includes business powerhouses such as Oprah Winfrey, Time Warner CEO Richard D. Parsons, Black Entertainment Television founder Robert L. Johnson, and American Express CEO Kenneth I. Chennault.

Wilder's slavery museum has no prominent CEOs on its board. (He says he hopes to make inroads in coming months.) After years of effort to find a location and delays in fund-raising, Wilder concedes that he won't meet his original target of a 2007 opening.

Fund-raising veterans say Wilder has a tough sell. Slavery "is an issue that sometimes people don't want to think about because it reminds them of how ugly life can be," says Adam Goozh, CEO of CreateHope, a firm that advises companies on charitable giving but has no role

THE DREAM
An artist's rendering of the museum's atrium

Wilder's campaign. More generally, orate belt-tightening and the large unt of charity directed to victims of ricane Katrina last year have made d-raising more competitive.

lans for the proposed slavery museum for a 290,000-square-foot structure looking the Rappahannock River in redericksburg, Va., halfway between Richmond and Washington and near four famous Civil War battlefields. The museum's design, by New York architect C.C. Pei, son of the legendary architect I.M. Pei, includes 10 permanent galleries, two libraries, several classrooms, a lecture hall, and a 450-seat theater. Its visual centerpiece is to be a full-size replica of the Portuguese slave ship *Dos Amigos,* reaching nearly 100 feet off the ground, which will be visible through a wall of glass to drivers cruising on nearby I-95.

Museum officials say $100 million is needed for building to begin, and they are seeking another $100 million to furnish the facility, create an endowment, and cover annual operating costs, estimated at $2.8 million to $3.5 million.

But the fund-raising requires a delicate pitch. Wilder argues that many businesses in the South and North alike benefited financially from the slave trade, including tobacco, cotton, textiles, banking, insurance, and shipping. "When you look at the totality of the picture, the purpose of slavery was money and commerce and trade," he says. "Slavery was about the subjugation of the human spirit, but it comes down to economics."

NO GUILT BUTTON

WILDER IS LOOKING for corporate cash to illuminate that past. Cosby says the museum should deliver a blunt message to business: "Slaves have never been repaid for the work they performed to make this country rich." But pushing the guilt button too hard can backfire, and Wilder is quick to point out that "it's not about reparation. It's about education."

Companies such as Philip Morris and Wachovia, which have acknowledged that their corporate predecessors had ties to slavery, are among those that have pledged to help. The museum will have "a lasting and measurable impact," says Frank Addison, Wachovia's director for philanthropy. "It doesn't hurt that it will bring jobs and development to that area," he adds. Wachovia, the leading bank in the Virginia-Washington corridor in terms of deposits, has pledged to make a "substantial donation" but has not specified the amount. Sources with knowledge of the situation say they expect it to be at least $100,000.

Wilder has raised only half of the $100 million needed for building to begin

Wilder hopes to persuade leading African American CEOs such as Time Warner's Parsons to help. But Parsons, a board colleague of Wilder's at predominantly black Howard University in Washington, so far hasn't agreed. "I told him: 'Dick, [museum fund-raisers] will be calling on you, but I'm coming [for you],'" Wilder says. "And he laughed." A Time Warner spokesperson declined to comment and said Parsons was unavailable.

It took years for Wilder to settle on a location for the museum. After attempts to place it in Jamestown and Richmond fizzled because of land costs or civic indifference, he was approached by developer Larry Silver, who donated land for the museum near a new project he bills as "North America's largest retail resort."

Wilder's effort has come a long way from that day in Senegal. The museum's staff of 12 has collected more than 5,000 artifacts related to slavery and has launched a Web site. A June gala at Washington's Warner Theatre attracted 1,400 people, who paid $100 to $300 to see a show headlined by Vereen and Cosby. Museum officials say they will target athletes, entertainers, and churches—as well as businesses—in coming months. "Governor Wilder can get done what he puts his mind to," says Silver, the developer who donated the land.

Wilder seems undaunted, in part because of how personal this cause is. He wants the attention not only of big corporations and white Americans but also of blacks, who may not have looked dead on at the history of slavery. As a young boy in Richmond, Wilder recalls, "my father didn't want to talk about it, even though his parents were slaves. My mother had to force him to talk about it.... And he would bite down on his pipe, clench it, and almost snap it in two. And he would tell a little, and I would ask for more, and he would say: 'I got to go now.'"

PHOTOGRAPH OF DOUG WILDER BY KATHERINE LAMBERT

Volcom: After The Wipeout

A Wall Street rating downgrade has torpedoed the activewear maverick's stock

BY CHRISTOPHER PALMERI

IT WAS A TWO-FOOT CURL THAT spun Richard R. Woolcott's world around. He was off the coast of Mexico's Baja Peninsula getting his photo taken for a surfing magazine in 1985 when the wave slammed him into a sandbar and broke his neck. Woolcott, 19 at the time, had to wear a halo-shaped brace bolted to his skull for three months. Doctors told him only 2% of patients survive an accident like his. "I was at the mercy of the ocean," he says. "It really was the turning point in my life."

His dream of professional surfing over, Woolcott redirected his competitive energy. In 1991, he launched a clothing line with friends. Today, Volcom Inc.—a name he made up out of whole cloth—is one of the fastest-growing brands in the $12.1 billion action sports industry, selling $50 board shorts and hooded sweatshirts to young surfers, skateboarders, and snowboarders. Thanks in part to imaginative marketing, the business has doubled since 2004, earning $29 million on sales of $160 million last year, results that won Volcom the No. 11 spot on *BusinessWeek*'s 2006 Hot Growth list of small companies.

HOT GROWTH COMPANIES

Now Woolcott is finding that Wall Street can be almost as treacherous as the waves off Baja. Volcom's share price plunged 30% on July 28 after Wachovia Securities analyst John Rouleau downgraded the stock to "market perform" and cut his earnings outlook for 2006 and 2007. The drop, to $20, essentially wiped out any gains the stock made since its debut at $19 in July, 2005. While Volcom expects to achieve its goal of boosting sales by 26% this year, analysts such as Rouleau worry that the company's growth is slowing due to weakening sales at its largest retailer, Pacific Sunwear of California Inc., which is seeing increased competition from rival Zumiez Inc. They're also worried that Volcom has maxed out at surf-and-ski shops. The worst-case scenario: Pacific Sunwear drops Volcom in favor of a younger brand or the exclusive line it already carries from Levi Strauss & Co.

Woolcott concedes that sales at Pacific Sunwear will be down in the second half but says the brand remains a strong seller in independent shops. He hired new employees to work directly with Pacific Sunwear, which accounts for 29% of Volcom's sales. New clothing categories such as sandals, boys' clothing, and women's swimwear should help, he adds. He also foresees higher numbers from Europe and more company-owned stores in the U.S. "We're fired up and stoked," he says.

While plenty of businesspeople try to market a lifestyle to consumers, few live their brand quite like Woolcott. The 40-year-old still surfs three times a week and snowboards 25 times a year. Like most of the company's 200 employees, Woolcott pads around Volcom's headquarters in Costa Mesa, Calif., in shorts and flip-flops. Until last December, he lived in a trailer park at the beach and left it only because the park closed. "I loved i double-wide," he says.

WOOLCOTT "We're fired up and stoked"

GUERRILLA TACTICS

WOOLCOTT ALSO KNOWS how to rea his market. The company has produced feature-length DVDs on surfing, sno boarding, and skateboarding. Volcom h its own record label, has bought nami rights to two municipal skate parks, a puts artwork from fans up on its Web si The company's sponsored athletes—cluding snowboarder Shaun White, w gold-medaled in the 2006 Olympics—a more than just photo ops. Several have p their own artwork on Volcom's boa shorts and T-shirts.

And Woolcott has practiced guerri marketing to the extreme. In 2004, instance, Volcom dispatched an RV the U.S. Open of Surfing in Huntingt Beach, Calif. Its crew then pretended have a breakdown and gave away shirts instead of actually sponsoring t competition. "Anybody could start clothing company, but to bring togeth that elusive energy, that is the tric part," says Duke Edukas, co-owner Surfside Sports in Newport Bea Calif. At the Volcom-sponsored sk park in Costa Mesa, fans like Seth Pr ner agree. "It's a cool brand," says t 12-year-old.

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Less Insult from Injury

Dan Robinson's ordeal with his son's rare illness led Intuit to develop software to untangle hospital bills

BY SUSAN BERFIELD

DAN ROBINSON'S SON, Zane, was born in November, 2000, with a genetic disorder so rare that only a few hundred people around the world have it. In the first year of his life, Zane underwent open heart surgery and an operation on his stomach. He suffered a hernia, dehydration, and other conditions that required emergency care. He was in the hospital for a total of 60 days; the cost came to $1.2 million.

Robinson, then a 32-year-old engineering manager at Intuit Inc. in Mountain View, Calif., and his wife, Kelli McLaughlin, who had been an elementary school teacher, were overwhelmed. For six months they paid little attention to the medical bills arriving in the mail almost daily. When Robinson finally sat down with the file box of papers he had accumulated, among them were a $100,000 bill for Zane's heart surgery that had not been sent to his insurance company, threatening letters about charges he had never received, and dozens of "explanation of benefits" statements from his insurer that he couldn't match to any bills.

To keep track of it all, Robinson did what came naturally to him: He wrote a software program. "It was buggy. You had to be a software engineer to use it," he says. "I wouldn't have inflicted it on anybody else." Yet he was sure that many of those dealing with serious health problems needed something like it.

A WORLD OF FRUSTRATION

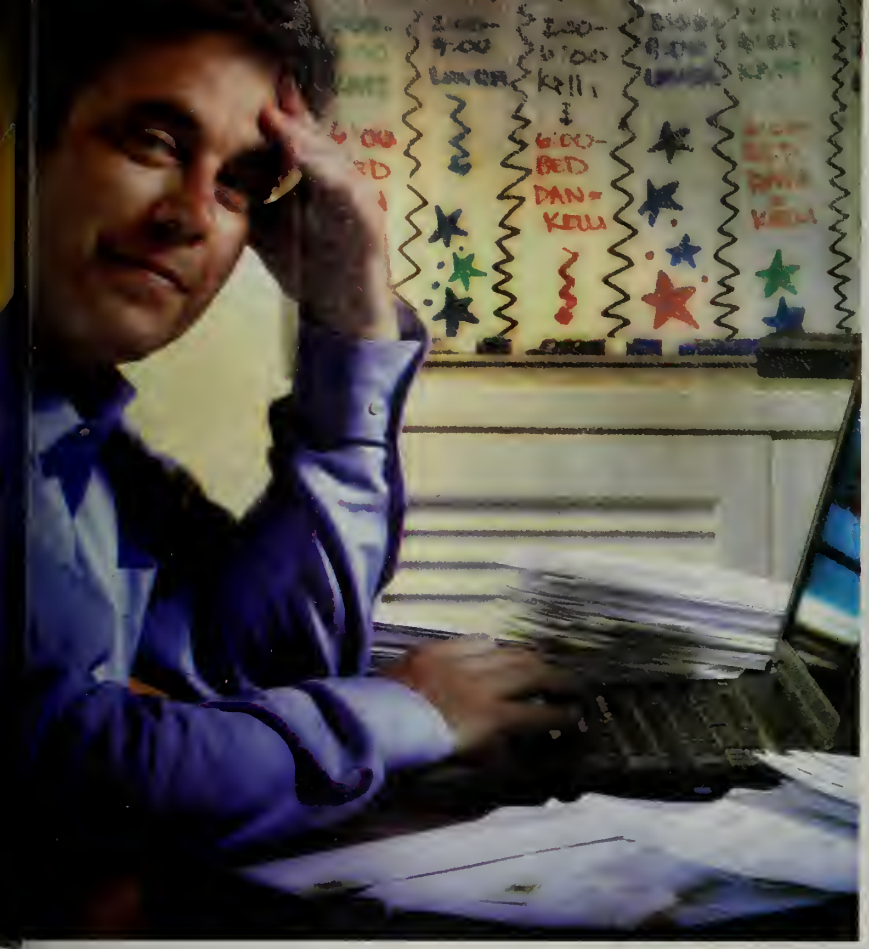
THAT REALIZATION, born of one man's distress, would eventually become central to Intuit's business strategy. It began with a new, well-received product, the Quicken Medical Expense Manager, which was introduced in 2005. The process of developing that software revealed to Intuit a world of consumer frustration. A medical system that is maddening, time-consuming, and expensive: It started to seem like a perfect opportunity for the company that examined the U.S. Tax Code and thought up TurboTax. As Chief Executive Steve Bennett says: "We are always looking for a large unmet need that we can solve."

In April, the $2 billion company announced a more comprehensive health-care initiative with UnitedHealth Group Inc. and others that Bennett hopes could one day be as important to Intuit as its $850 million QuickBooks business is now. It was a umphant moment for Robinson, though he had no idea it was coming. bewildering encounters with the medi system had, in the meantime, spur him to make a career change that he l long been contemplating.

When Robinson first mentioned business idea to colleagues in 2001, was met with even less than skepticis indifference. He had written StreetFinc the first software program of its kind, Rand McNally & Co. in 1995 and l worked on the personal finance softwa Quicken, at Intuit for three years. Still, wasn't surprised by the reaction. "Th wasn't much thought about develop new products then," he says. "And I v an engineering manager, not a marketi

Two years later, though, Intuit's cult had begun to change, especially at Qui en, whose growth had stalled as onl banking lessened the need for softwar manage personal finances. Peter Karp then in charge of Quicken Solutic Group and now chief marketing a product management officer, was you creative, unbound by tradition. He wa ed his staff to think of innovation as m

ZANE AT 5 Dan and Kelli faced expenses of $1.2 million for his operations and care



ROBINSON "Health care is messed up. There ought to be lots of ways to make it easier, and people will pay for that help"

simply improving its core software gram. Karpas helped set up a "green- t process" to approve, guide, fund, sometimes kill ideas for new prod- . At each step, the employees were to ver one essential question to the sat- ction of a group of executives. After ntifying several people, including inson, who "had that entrepreneurial k," as Karpas says, he issued a chal- ge: "Find something that excites you, orward, and answer these questions." ane's health troubles were well-known ntuit. Robinson had missed work to for his son and, later, to contend with government agencies that provided ices to the disabled. Partly because inson's desire to do something to help ple with their medical expenses was so nse, Karpas initially regarded it as newhat quixotic. When Robinson hed his idea to Karpas over lunch in fall of 2003, he received only a slightly re encouraging response than he had ore: total uncertainty. "I didn't see or the big unmet need," Karpas recalls. "I Dan's need."

But Karpas agreed to give Robinson time (half of his workweek for how- r long it took) and, a little later, the re- rces (including a partner, Kate Welker, o could help with market research) to ld a case that his financial stress was his problem alone. Robinson and Welker visited dozens of people in their homes to see how they handled all of the bills and statements generated by the health-care system. Their conclusions were that people would spend hours to get even a few dollars out of their insurance companies, and that they wanted some way to assert control at a time when their lives had been upended by health concerns. Based on Intuit's experience with Quicken, Robinson estimated that of the many millions struggling to keep up with their medical paperwork, a couple hundred thousand would be likely to use some kind of financial software.

Around the office, Robinson tried to sell his project at any opportune moment. As he says, "the first sentences of every conversation were: 'Health care is a $1.3 trillion business, and we don't have a piece of it. Health care is messed up. There ought to be lots of ways to make it easier, and people will pay for that help.'"

"GET IN THE GAME"

BY FEBRUARY, 2004, Robinson was ready for the crucial "proof of concept" presentation, after which only 18 of the hundreds of projects continued to receive funding. He won approval, which, he says, "was a huge surprise to everybody. Most people thought this was the end of Dan's experiment." For Karpas, the most convincing part of Robinson's talk was an 18-word statement of the precise unmet need his software would satisfy. It was: When I get a piece of paper in the mail, I will know what to do with it.

As Robinson worked full-time with more than a dozen employees to develop the software and marketing plan, he struggled with a difficult decision. He had applied to the University of Minnesota Law School and been accepted with a scholarship for the fall of 2004. Dealing with patient outreach groups and talking with Intuit consumers convinced him, he says, "that a lot of these people need a good lawyer, not just good software." His own legal disputes with the state of California over Zane's eligibility for various services and the presentations he made to Karpas helped him realize that he could be very persuasive. He left Intuit for school eight months before Medical Expense Manager was launched.

As Robinson predicted, the software was quickly adopted by a select group of people with serious medical problems; by Intuit's standards it was a modest moneymaker. More important, says Bennett, is "that it helped us get in the game." In November, 2005, Intuit appointed its first general manager for health care, Dan Levin, who had been vice-president for product management. He set out to find other companies to work with. "We have a very good handle on what we do well," he says. "It was clear we needed strong partners." Although details about upcoming products are scarce, the ultimate aim is to provide consumers with easy electronic access to all their medical information, whether it's held by insurers, hospitals, pharmacies, doctors, or employers. (Medical Expense Manager requires that information be entered by hand.) Intuit executives believe this could revolutionize health care, but, as with Quicken, success depends on the cooperation of all these institutions. The initial offering, due in mid-2007, is "version one in a multiyear plan," says Bennett.

Robinson says he is astounded by what Medical Expense Manager has led to at Intuit. He's in the Bay Area this summer working at a law firm and in touch with former colleagues. Kelli and Zane, "a happy, laughing boy whose health is great," he says, are with him. "I'm happy with my decision to go to law school," Robinson adds. "But I can't help thinking what would have happened if I had stayed."

AGENDA Martin hopes the auction will spur broadband services

Now on the Block: Chunks of the Sky

The biggest U.S. wireless spectrum sale ever has more than 160 bidders jockeying for position

BY RONALD GROVER

OUT ON THE WESTERN plains of North Dakota, Royce Aslakson, CEO of the Reservation Telephone Cooperative, just wants a small piece of the airwaves. For Reservation, which serves 19 communities and 7,500 customers, some of whom are Native Americans, it will mean creating a little competition among cell-phone services.

Back East in Philadelphia, Comcast Corp. CEO Brian L. Roberts wants a whole lot more wireless spectrum. His plan is to offer a cell-phone service to his 22 million cable subscribers to keep them from jumping to satellite. His arch nemesis, Rupert Murdoch, whose News Corp. owns a stake in DirecTV Group, is looking for spectrum, too, for data and cell-phone services that will keep Roberts from getting the upper hand.

Starting on Aug. 9, these players and more than 160 others, large and small, will be pitted against one another in an auction by the Federal Communications Commission for the largest chunk of U.S. wireless spectrum ever put out to bid. The auction, which could raise as much as $15 billion for the government, is considered a key part of FCC Chairman Kevin Martin's plan to push new broadband technologies. More important, the auction of high-frequency spectrum, which had been used for pagers, radio telephones, and government communications, could usher in a major rejiggering of the telecommunications landscape.

Divvying up more spectrum among a slew of new competitors will certainly be a plus for consumers able to choose from a new array of wireless options. Cable and satellite operators are making their biggest push yet into wireless, with the potential to threaten the established networks operated by such players as Verizon Communications and Cingular. Smaller outfits like Aslakson's Reservation could snap up spectrum in local areas around the country and roil plans the big guys to buy wireless spectru piecemeal to assemble a fuller netwo "It's the auction of a lifetime for so companies and the biggest we'll see i while," says James L. Thoreen, a parti with adviser GVNW Consultant, whic helping 11 smaller telecom bidders.

> Who wants airwaves over the Gulf of Mexico? Lots of folks

LIPS ARE SEALED

THE AUCTION is expected to stretch more than a month, with the approved b ders wheeling and dealing to suit th agendas. Bidders include wealthy indiv uals eager to speculate on future uses the spectrum. One Michigan video ga arcade owner was briefly in the bidding create a broadband gamers' network New York money manager put do $20,000 to bid on the rights over the G of Mexico, in part to woo oil rig work away from satellite phones. He faces 40 tential competitors for the tract, includi the Dolan family of cable operator Cable sion System Corp. and money mana Mario J. Gabelli (permitted to participat the auction even after paying fines for v lating previous wireless auction rules).

The biggest players registered to are not commenting on their plans, clearly it is the latest battle in the cab satellite wars. Comcast is part of a cons tium of cable giants in a joint venture w Sprint Nextel Corp., pledging $637.9 n lion to create a national cell-phone serv Satellite rivals DirecTV and EchoS Communications formed Wireless L and have plunked down $972.5 milli with plans to offer either cell-phone wireless data services.

Nearly two-thirds of the 168 bidders small enough to qualify for FCC spec bidding credits, no matter how mod their ambitions. Reservation, for one playing catch-up. Covering 5,700 ac that comprise farmlands, Indian reservation, a ballistic missile silos, the op finally dumped its rot phones in the late 1980s a only recently began offeri Internet service. For Res vation, the cost of entry v hefty—it hired a Washi ton law firm and put $37,000 for a single swa of territory that will re less than half its custome It would like to partner w another phone co-op that is bidding the wireless rights to the other half of turf. "We just want a little spectrum," s Aslakson. Unfortunately, so does j about everyone else.

So That's Why It's So Expensive

Blame insurance, not just tech, for spiraling health costs, says an MIT economist

HOWARD GLECKMAN

ECONOMISTS HAVE LONG believed that technology is the main reason that health-care costs are rising so rapidly. The endless stream of innovation, from new drugs to delicate tools for microsurgery, the theory goes, largely explains why medical spending has exploded from 5% of the U.S. economy in 1960 to 16.5% today. According to some studies, as much as 75% of that growth could be laid at the doorstep of tech.

ELSTEIN
lied data
g back
e '60s

Now a young economics professor at the Massachusetts Institute of Technology is challenging the conventional wisdom. After studying data going back to the 1960s, Amy N. Finkelstein has concluded that the real culprit for the rapidly rising cost of health care is the massive expansion of medical insurance over the past 40 years. Sure, new technologies play a role, but doctors, hospitals, and consumers adopt them so freely largely because insurance foots the bill. "Where does that technological change come from?" asks Finkelstein, 32, who lives in Cambridge, Mass., with her economist husband, Ben Olken. "I am trying to get inside that black box."

If Finkelstein is right, her work could change the way policymakers and the companies that pay for most medical care think about costs. For example, if individuals have to pay more for their care through high-deductible health plans, they may cut spending. Her theory could also spur the drive for evidence-based medicine, the effort of some reformers to encourage the use of only those treatments that have been proven to work (BW—May 29).

Already, Finkelstein's analysis is shaking up views across the political spectrum. "This is pathbreaking work," says Joseph R. Antos, a health economist at the conservative American Enterprise Institute. Adds the more liberal MIT economist Jonathan Gruber: "This really changes the whole landscape in the way we think about health economics."

Why is insurance so important? One obvious reason, Finkelstein believes, is that consumers opt for more care if someone else pays for it. But the more significant effect may be that insurance guarantees a steady source of revenue for hospitals and other health providers. Such ready cash encourages them to build new cardiac-care centers and stock up on the latest high-tech equipment, knowing it will be paid for. "If you produce expensive new things for medical care, people will buy them," says Paul Ginsburg, president of the Center for the Study of Health System Change in Washington. He has found results similar to Finkelstein's by looking at medical spending patterns in 12 U.S. cities.

Finkelstein's breakthrough confirms a theory first advanced almost 30 years ago by Harvard economist Martin Feldstein. At the time he didn't have detailed health-cost data to prove his case. Then in 1987 a massive Rand Corp. study concluded that technology accounted for more than half of the rise in health-care costs. Insurance, Rand figured, increased costs by just 10%.

So Feldstein's theory gathered dust until Finkelstein discovered the proof by sifting through long-forgotten paper records in MIT's library. There, she found that hospital spending soared after the federal Medicare program began in 1966. "I thought, why am I getting such a large number," she remembers.

Finkelstein had the papers scanned and shipped to a company in Cambodia, where it took 18 months to turn the records into usable data. The story they told was dramatic. In regions such as the South, where most seniors had no insurance, health spending soared after Medicare. But in New England, where many already had coverage, Medicare had much less impact on costs.

Not everyone buys her conclusions. Some think she has overstated the importance of insurance. Others question whether her results apply to private coverage as well as Medicare. But she has prompted many experts to rethink their long-held views. And now that Finkelstein thinks she's figured out how much insurance has increased costs, she wants to find out whether all that extra spending has paid off with better care.

THE STAT

50%

The share of medical inflation accounted for by insurance. Until now, technology was considered to be the more powerful factor.

Data: Amy Finkelstein, Massachusetts Institute of Technology

JAY REED

The Dream Dorm

These high-tech toys won't raise your college student's grades, but they can't hurt morale. **BY JAMES K. WILLCOX**

IT'S ALREADY STARTING: the annual rite known as Packing for College. This year, tucked in amid the Chuck Taylor high-tops and the 300 thread-count sheets will be an imposing array of high-tech gear. Some of it is designed with the academic experience in mind; most of it, to deck out those austere four walls for some first-rate, after-hours recreation. Beyond the bare essentials, a laptop computer and an iPod, here's a look at what the well-appointed dorm room will be sporting this fall.

1. **The LCM-22w2 from Westinghouse** is a wide-screen LCD monitor that multitasks. This 22-inch model ($499) is perfect for watching DVDs or playing fast-paced video games as well as supersizing Microsoft Word documents and spreadsheets.

2. **Kef's KHT3005 5.1-channel speaker system** ($1,500) are the hippest speakers going. Besides four cast-aluminum eggs and an oblong center-channel speaker, there's a 250-watt subwoofer that serves up a bottom end even J-Lo would envy.

3. **ATI's TV Wonder 650 card** ($129) or its USB equivalent turns a PC into an entertainment powerhouse. Plug it in and you have a digital video recorder that can pause and rewind live TV, even HDTV.

4. **Ace Bayou's new padded X Rocker II** ($99) comes with a built-in sound system that works with TVs, music players, and video game systems. Besides the subwoofer, a vibration mechanism helps deliver serious booty shaking.

5. **Tivoli Audio's oddly named iYiYi iPod clock radio** ($299) is a dock that combines an AM/FM tuner, two 3-in. speakers, and a clock that uses the tunes in an iPod to sound a wake-up call.

6. **Dada's Code M sneakers** ($200) put sing as well as spring into your step. An MP3 player built into the shoes holds 100 songs and beams them up to wireless headphones.

7. **Kensington's MicroSaver DS Notebook PC lock** ($55) will secure that expensive PC—and all the class notes and term papers stored on it.

8. **The N1 Wi-Fi router** ($149) from Belkin creates the speediest wireless network yet, fast enough to stream video, and the blue-hued status icons are way cooler than LEDs.

9. **Belkin's Wi-Fi Phone for Skype** ($190) is a sleek black handset that allows for voice-over-Internet calls from dorm-room networks or public Wi-Fi hot spots, and doesn't need to hook up to a PC.

10. **JanSport's Dreamer backpack** ($250) offers the latest in geek chic, controlling both an iPod and a Bluetooth cell phone via a strap-mounted keypad. A padded sleeve inside keeps a laptop secure until it's safely back in the lair.

BusinessWeek online For more on great back-to-school technology, go to businessweek.com/extras

JOHN HERSEY

1
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DELL XPS M1710

Big Laptops On Campus

These mighty notebooks can meet most students' needs—even those of gamers. **BY ANDREW PARK**

VIRGINIA POLYTECHNIC Institute & State University prides itself on being a PC pioneer. In 1984 the Blacksburg (Va.) school was the first public institution to require incoming engineering students to buy a desktop. The mandate for this year's engineering frosh: slick laptops that can double as tablet PCs.

Tablets that can switch their displays to allow users to take notes by hand have been around since 2002. Most PC makers, such as Gateway, Hewlett-Packard, Lenovo, and Toshiba, offer a version more to fill a niche than to sub as a full-featured PC. In the past, buying a tablet generally meant giving up extras you may need or want.

That's not the case with Fujitsu's newest convertible tablet, the LifeBook T4210, which starts at $1,729. It runs the latest Intel processors as other speedy laptops do and comes with optional Bluetooth wireless capability and multiple slots for memory cards. And unlike Lenovo's ThinkPad X41 Tablet, say, you can have an onboard CD or DVD drive. You can even order the T4210 with a DVD burner.

Most students, though, will probably choose one of the mainstream notebooks. A good choice is HP's Pavilion dv5000, one of the best all-around laptops. It starts at a mere $729, but the price can climb to well over $1,000 with a performance-enhancing processor or a DVD burner for digital moviemaking. Still, the dv5000's elegant silver and piano-black finish, smart layout of ports and inp and front-mounted speakers make it l and feel like a much pricier machine.

The dv5000's 15.4-in. wide-screen play, which is coated with a new glo finish designed to boost brightness movie viewing, is an optional feature t most manufacturers are offering for first time. It produces a brilliant pict when showing an episode of *Lost* on D in a darkened room, but under bri lights you'd be hard put to get away fr the glare. Those who plan to use the l top under bright, classroom lights or c doors might want to stick to the stand screen. Another good choice: Dell's In iron E1505, a similarly versatile and c tomizable laptop that starts at just $6

WINDOWS SAVVY

THESE DAYS, APPLES are equally fordable, and they now use Intel's C Duo chips, just like HP and Dell mod That means that they can boot up W dows XP and run applications desig for PCs, which eliminates the main ar ment against choosing an Apple.

The new MacBook starts at $1,0 The minimalist design will attract s dents, but it's full of practical inno tions that parents will appreciate, t such as a magnetic power cord conn tor that safely snaps off if someone t over it. Its skinny 1-in. profile and 5.2 heft make it highly portable, but th are drawbacks: The 13.3-in. displa too diminutive to double as a d room DVD theater, and 64 MB of vi memory isn't enough for serious ga ing and multimedia. If that's wh needed, step up to the MacBook P which comes in 15- and 17-in. varie that start at $1,999.

Presto, Change-O!

Fujitsu's LifeBook T4210 Tablet PC can be used as a conventional laptop...

...Or with the screen swiveled right or left for sharing presentations...

...Turn it aroun completely, fold it down over th keyboard...

MOVABLE BEASTS

Students can no longer survive on campus without a laptop. Here are some of the best on the market:

DEL	Alienware Aurora m9700	Apple MacBook	Dell XPS M1710	Fujitsu LifeBook T4210	HP Pavilion dv5000	Toshiba Qosmio G35-AV600
ICE	Starts at $1,799	Starts at $1,099	Starts at $2,400	Starts at $1,729	Starts at $729	$2,300
REEN SIZE	17"	13.3"	17"	12.1"	15.4"	17"
E GOOD, E BAD, D THE TTOM IE	Optional dual graphics cards will bump up the price by $400, but they make this gamer tough to beat	Whether in black or white, this stylish laptop is easy on the eyes, the wallet, and, at just 5.2 lbs., the shoulders	The reigning gaming champ is media-friendly, too, unless you need a built-in TV tuner	This fast, lightweight, fully featured laptop converts to a tablet PC for easy note-taking	Nicely priced portable can't do it all but has power to spare for most students	This laptop packs a complete digital entertainment center, but it's too heavy to carry around a lot

Data: CNET Networks Inc.

rue graphics hogs, though, will opt what the PC industry refers to as sktop replacements." A better name ht be "desktop destroyers," since the hines now perform comparably with itower desktops, and their portability, igh just barely for some models, es them a far better option for anyone doesn't want to be tied down. At the of that list are hard-core gamers, but so includes amateur Scorseses.

ake Dell's XPS M1710 with its high-olution 17-in. wide-screen display. ting at $2,400, it's way pricey. But would be hard-pressed to find a lap- with more real estate for the eyes and ers. No machine beats it on speed, nks to options like a dual-core cessor running at 2.33 GHz and the most powerful graphics chip Dell has ever put in a laptop, an NVIDIA GeForce Go 7900 GTX with 512 MB of dedicated video memory.

The M1710's garish metallic black or red case with glowing XPS logos is designed to get gamers' hearts racing, but there's a wider audience for this 9-lb. beast. The standard features include Microsoft's Windows XP Media Center Edition 2005 and Dell's MediaDirect system. The latter allows quick access to music, photos, and movies without booting up Windows (and puts the control buttons conveniently on the front edge).

Unfortunately, Dell left out an internal TV tuner for those who want to watch and record live TV. Instead, it offers one on a $130 card that slides into the side of the laptop. The company says that making space for an internal tuner would have added unnecessary weight and bulk. If you disagree, you should look to Alienware's Aurora m9700, which starts at $1,799, has a tuner and optional dual graphics cards, and boasts a more graceful design than the Dell.

If that's not good enough, a few top-of-the-line laptops promise a home theater-like experience but are still portable. Dell's XPS M2010, with its 20-in. liquid-crystal display, is a stunner, and so is the price tag, $3,500 or more. A more reasonable choice is Toshiba's $2,300 Qosmio G35-AV600, the latest in its line of mediacentric portables. It's difficult to imagine that Toshiba left anything out of this more than 10-lb. laptop. There's a dual-layer DVD burner, powerful Harman Kardon speakers, and a dozen ports for connecting to other gadgets.

But it's the multitalented tablet PCs with their show-off appeal that are capturing the fancy of the incoming class. When Virginia Tech freshman Walter Mangual is finished doing homework on his LifeBook T4210, he switches to the shoot-'em-up *Half-Life 2*. When he's in class, the 12.1-in. display swivels around into slate mode, allowing him to take notes by hand, mark up professors' presentations, and collaborate with classmates on team projects. Says Mangual: "I don't really need the keyboard."

ecomes a
that you can
ner portrait or
e mode

BusinessWeek weekend

To see more notebooks, watch *BusinessWeek Weekend*. Check local listings or go to businessweek weekend.com for video clips

To view full reports and related information, go to the links listed below or visit www.expert-insights.c

New Network Technologies Optimize Security Systems

The growing need to protect people, assets and property has led to an increased focus on security in the workplace. While many facilities currently have security systems in place, innovative technologies are advancing the employment of networked systems to the area of physical security. Newly developed network video surveillance devices offer compatibility with legacy analog based systems, allowing seamless co-existence of analog and digital products, or enable migration to a complete digital platform.

Network security solutions are quickly being embraced due to their convenience, lower cost of installation and ownership, and increasingly superior image quality. For users, finding the optimal hardware to place on the network is of critical importance. This is particularly true for the cameras at the system's front end and recorders at the back end, as these devices define the quality of the captured video information.

With the advent of the network in security applications comes the need for users to integrate many components, both hardware and software, from different sources. Hardware manufacturers at the forefront are already providing a simplified approach for users with the formation of solution developer networks and open-platform partnerships with complementary manufacturers. Also now available to users is specialized, enterprise-level consul assistance in the form of planning, design, ins tion, and implementation of total networked v surveillance solutions. As a result, more adva network-based video surveillance systems con to emerge in high-profile venues such as ball p banking institutions, and corporate headquarte

Integrating all security functions within one work, incorporating both wired and wireless t nologies and accessible from every type of work-enabled device, will become the norm network security technologies continue to d op, video surveillance will integrate more other essential operations within organizations facilities, providing the requisite safety and sec to protect important assets.

To read the full report, go to www.expert-insights.com/panasonic.asp

Panasonic Security Systems

Panasonic Security Systems has been the recognized leader in professional video surveillance for nearly 50 years. With a comprehensive lin intelligent analog, hybrid, and IP video surveillance solutions, Panasonic's renowned technology, quality and reliability deliver peace of min and around facilities. Panasonic's expert team of enterprise engineers offers consultative planning and design assistance to the education, hea care, transportation, sports and retail industries, as well as the government. www.panasonic.com/security/BW • 866.PAN.CCTV (866.726.22

Integrating Vital Security Systems At The Enterprise Level

Integration typically involves the sharing of information between two or more systems with the objective of providing a common user interface. This level of connectivity increases efficiency and allows the integrated system to make "intelligent" decisions based on the status of either or both systems.

Security systems operating on the enterprise level incorporate those security technologies most commonly deployed in large scale facilities: video surveillance systems, access control systems, fire and alarm systems. These can be configured, operated and changed in countless ways given the nature of the system. Once the network connection is established and a common interface is determined for all of the integrated systems, the configuration can be tailored to meet the user's immediate and changing needs. Unlike traditional hardware driven systems, the enterprise security system is limited only by the power of the software controlling it.

In security and surveillance operations, there are a number of systems that can provide information valuable in identifying breaches of procedure, and trends in abnormal activity. By storing the shared data from these systems and providing a common interface capable of "mining" the database, specific combinations of events can be readily ide and users alerted to defined behavior.

The most significant benefits of enterprise rity systems include the capability to manag the systems from a centralized location, location on the network. In addition, ent security systems allow for systems architect be distributed along several network node the ability to share data between multiple sy

To design, install and deploy an enterpris security system, it is key to find a systems c er and integrator with knowledge and expe in the latest technologies, who has been pr sively applying the system building block have led to the realistic deployment of ent level security systems.

To read the full report, go to www.expert-insights.com/nav.asp

North American Video is one of the premier security systems integrators in the country and was named "Systems Integrator of the Year" by Se Distributing & Marketing in 2005. From system design through equipment installation and training, North American Video provides unmatche formance, integration, customer service and support. With offices located around the world, North American Video's extensive client list inc casinos, government, schools, corporations, retail, medical and financial institutions. info@navcctv.com • 1-800-714-0717 • navcctv.com

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e CEO and Security: lew Priority in the Boardroom

's CEO faces a new challenge. Already con- with regulatory compliance, consumer pri- /s, and the almost-daily occurrence of media announcing high-profile data security s, they are now forced to "own" security as

uarding the organization and its sensitive vital to how investors and customers view a y's ability to function successfully. CEOs can er focus only on risk tolerance and mitiga- ney must now weave all facets of security with the overall vision and mission of the ation. The key drivers for this change are:

1. Corporate Governance: CEOs are responsible to their board of directors and investors to protect all the assets of the company.
2. Organizational Complexity: Each decision-maker has a different role. The CIO defines security differently than the Physical Security Officer or the Risk Manager. The CFO incurs costs that appear to be redundant. The COO is concerned about organizational efficiency. How do they come together?
3. Regulatory Requirements: Laws are constantly changing as breaches come to light, and security must be seen as fully embedded in the strategy of the company.
4. Employee Demand: Safety and security will increasingly gain attention as competition for knowledge workers increases.
5. Consumer Demand: Savvier consumers view privacy and data protection as a critical component in their decisions to conduct business with any company.

Help with this new mission is finally emerging: the enterprise Security Systems Integrator (SSI) has the ability to unify an organization's security functions to bridge the gap between physical and logical security, align the security mission with the overall business objectives of the organization, and harmonize the technical architecture between physical and IT security, which will result in increasing profits and reducing the total cost of ownership (TCO).

To read the full report, go to www.technology-reports.com/asg_asp

Aronson Security Group, Inc. (ASG) is the premier independent integrator of enterprise security solutions. Building on a strong reputation of engineering and service for over 40 years, ASG provides security expertise to premier organizations throughout the United States. ASG is also the host of the ASG Security Summit & Expo. For more information, please visit ASG at www.aronsonsecurity.com, the Summit website at www.asgsecuritysummit.com, or call our headquarters at 888-284-3553, ext. 2.

w Motion Detection Technology volutionizes Security Systems

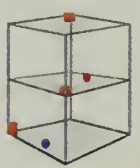
ing Technology, New Innovation – Motion on sensors based on ultra-wideband (UWB) ogy offer expanded capabilities over existing ave, infrared and other motion sensing logies. UWB was recently approved for use FCC, opening the door for the development mmercialization of new applications. The industry and all organizations needing ed security will benefit greatly from new based sensor systems.

ke most other transmitters that operate in quency domain, UWB motion sensors… o not need a lens to 'see' into the world

2. Are capable of detecting motion through concrete walls and from under roads
3. Require very little transmitter power – less than a cell phone
4. Operate in the time domain, enabling real time distance measurement of the target
5. Provide target velocity in real time

This ability to detect motion through walls changes the security paradigm. Totally hidden, the sensors are clandestine, tamperproof, weatherproof and virtually undetectable. These sensors can be integrated with existing indoor and outdoor security systems that are Internet compatible. For example, these motion sensors are being used to direct CCTV cameras in outdoor perimeter security systems for quicker target detection. Alarms can be monitored remotely via the Internet.

In the future, three sensors working together will be able to track motion in 3D, giving a greatly enhanced image of people inside buildings, as illustrated in the graphic.



Other current uses for this technology include portable, wireless life detection systems for First Responders for Search and Rescue in debris piles and collapsed buildings and even smaller, more portable systems for police offiers to use as personal protection devices.

To read the full report, go to www.expert-insights.com/ultravision.asp

UltraVision Security Systems, Inc. (UVSS) builds on 35 years of UWB technology developed by its parent company Geophysical Survey Systems, Inc., the world leader in ground penetrating radar systems. UVSS specializes in through-wall motion detection and life detection systems using both UWB and microwave technologies. Microwave technology has been licensed from BAE Systems. 866-374-9732 • www.ultravisionsecurity.com

Desktops for the Power Player

Speed and storage are the Holy Grail for gamers and music, TV, and film collectors. **BY ARIK HESSELDAHL**

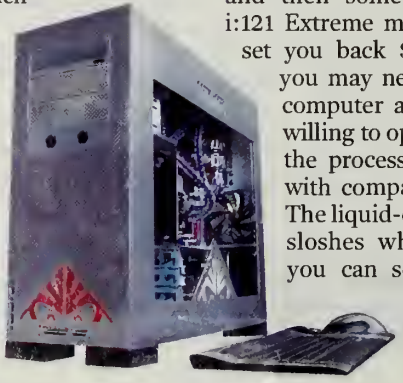
LAPTOPS ARE THE COMPUTER of choice for most college students. But design, film, and engineering students, not to mention anyone with a serious gaming habit or the desire to store several seasons' worth of *24*, will need the brawn that only a desktop delivers.

Hard-core gamers and power users flock to the custom PC boutiques, such as Falcon Northwest, VoodooPC, as well as Alienware, now part of Dell. Why? They like the companies' attention to detail, customer service, and outlandish designs.

Falcon's flagship PC is the Mach V. Loaded with the fastest processor chips from Intel and NVIDIA's top-of-the-line graphics processor, the machine will run you $3,272 in a basic silver case. But with more upgrade options than you can shake a joystick at—a faster graphics card, an extra hard drive, or a better sound system—you can easily push that price to more than five Gs. One unique extra: a custom, hand-painted case to match the color of, say, your car or the logo of your favorite band (mostly $150-$450, with some elaborately detailed designs climbing much higher). If that package is too steep, you can always choose Falcon's Talon, which can be had for less than $1,900, though that's without a fancy case or as many options.

FALCON NORTHWEST MACH V EVERQUEST II
Starting at $3,272
This custom hand-painting added $600; others can cost $150-$2,000

VoodooPC pushes performance—and price—right to the boundary of reason, and then some. Its Omen i:121 Extreme machines can set you back $6,000. But you may never have to buy a new computer again as long as you're willing to open the case and replace the processor and graphics chips with company-supplied upgrades. The liquid-cooled Extreme actually sloshes when you move it, and you can see the cooling system in action though the tempered-glass picture window on the side of the box. Does it work? You bet: The computer is so quiet it makes the giant on rival Alienware's flagship sound jet engines.



VOODOOPC OMEN i:121 EXTREME
$4,320-$6,000
The liquid-cooled version is so quiet it makes the giant fans on rival machines sound like jet engines

You probably won't shop for a com er without at least looking into what can get from Dell. Its new XPS line aimed squarely at gamers. The XPS launched in July, starts at $1,595 sports the newest Intel Core 2 processor. Out of the box it works both Windows XP and Windows M Center and is ready for Microsoft's f coming Windows Vista, now schedul be released to consumers in early 20

If you plan to use your PC for watc and recording TV and movies and b ing a video archive, which is the w idea behind Windows Media Center, you migh better off with an Hewlett-Packard has pu the concept of the enter ment PC further than one. Its Pavilion m75 which starts at $899, cc with removable hard d that can be popped in out while you're using computer. HP calls t personal media drives, you can buy as many as need. Prices depend capacity and range $150 to $350.

EASIER ON THE WALL

YOU DON'T NEED kind of limitless stor Take a look at Hew Packard's Pavilion line s7500 series, w starts at $449. Physically, third the size of the reg Pavilion, and if you pony u the $60 TV tuner, you can use it to watch and record vison shows.

Finally, don't rule out Mac, if only because it's al entirely immune to the vir and other nastyware plague the Windows w Now that the Apple line uses chips Intel, it meshes more comfortably—v needed—with the Windows-centric lege environment. The Mac Mini—a the size of a tissue box—starts at $ the iMac, built around a flat-panel sc at $1,299. If you're interested in the A flagship, though, hold off: The rep ment for the PowerMac G5, which feature the Intel processor, will be before the end of August.

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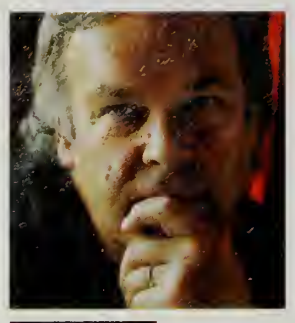

BY ROBERT PARKER

Where 2003 Was a Very Good Yea

GROWING GRAPES in the colder latitudes, such as France's Northern Rhône appellations, is dicey. In cool summers, the fruit may not fully ripen, which ca lead to thin, harsh wines. Blistering heat can result in overripe fruit, another challenge to the vintner. But in 2003, hot weather and deft winemaking in t Northern Rhône teamed up to produce the best red vintage since 1978. Thes reds are made from syrah, the same varietal we featured last week in wines the Central California Coast, where the weather is usually ideal for grapes.

E. Guigal 2003 St.-Joseph
90 points. The straightforward St.-Joseph exhibits a deep ruby color along with plenty of black cherry and currant fruit, as well as notions of herbs and wet rocks. Medium-bodied, pure, and rich, it is best consumed over the next seven to eight years. $27

Albert Belle 2003 Crozes-Hermitage Cuvée Louis Belle
90 points. Soft, broad, and heady, this wine reveals some wood influence, but it is dominated by black fruit. Full-bodied, velvety textured, and outstanding, it should be enjoyed over the next five to six years. $30

Paul Jaboulet-Ainé 2003 Crozes-Hermitage Thalabert
90 points. This brilliant Crozes-Hermitage Thalabert boasts a deep purple hue as well as gorgeous aromas of tapenade, blackberries, cherries, incense, and licorice. Voluptuous and full-bodied, with low acidity, ripe tannin, and gobs of fruit and glycerin, it should be consumed over the next 10 to 15 years. $33

Delas Frères 2003 St.-Joseph François de Tournon
91 points. An outstanding effort, the mineral and floral-scented wine has a dense purple color, followed by a beautiful nose of minerals, white flowers, crushed rocks, crème de cassis, and blackberries. This tannic wine ideally needs two to three years of cellaring, and should keep for 10 to 15 years. $36

RHONE HARVEST Domaine Guigal gathers in the syrah

J.L. Chave 2003 St.-Joseph
93 points. One of the finest St.-Josephs I have ever tasted. Revealing gorgeously thick, rich notes of raspberries, crème de cassis, licorice, black truffles, and spice box, it boasts superlative fruit, a voluptuous texture, medium to full body, and silky tannin. This beauty should drink well for to 15 years. $40

René Rostaing 2003 Côte-Rôtie
93 points. The deep ruby/purple-colored possesses great concentration in additio notes of licorice, white chocolate, bacon blackberries, and cassis. This unctuously textured, fleshy, low-acid wine begs for consumption over the next seven to eight years. $50

Patrick et Christophe Bonnefond 2003 Côte-Rôtie Côte Rozier
96 points. This cuvée boasts an inky/purpl color along with an extraordinary perfume graphite, bacon fat, melted licorice, crème cassis, raspberries, and tapenade. Althou extremely full-bodied, even huge, with mas concentration and an unusually intense st it reveals surprising freshness and definiti Moderately tannic and deep, it requires fou five years of bottle age, and should drink w for 20 to 25 years. $70

Visit **www.eRobertParker.com** for the Internet's most active wine bulletin boa tens of thousands of tasting notes, or t order his recent book, *The World's Greatest Wine Estates: A Modern Perspective*. You can also subscribe to Parker's newsletter, *The Wine Advocate*. Request a sample copy at: *The Wine Advocate*, P.O. Box 311, Monkton, MD 21

Wines rated from 96-100 are extraordinary; 90-95, excellent; 80-89, above average to very good. For more Parker picks, go to businessweek.com/e

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Extreme Global Investing

Spurred by the weak dollar, some are putting all their chips overseas. And cleaning up. BY LAUREN YOUNG

CINDY LEWIS IS A 52-year-old divorced suburban mother of two who drives a Ford minivan and is active in the PTA. An extremist? That's not exactly the word that comes to mind. But in her investing habits, she's extreme all right.

Lewis has a $3 million portfolio, and every penny is invested in foreign stocks and bonds. There's nary a Cisco, Dell, Intel, Citicorp, or Wal-Mart in the mix. Just things like Kiwi Income Property Trust, a New Zealand real estate investment trust, and the Aberdeen Asia-Pacific Income Fund. Different stocks in her portfolio are up 50%, 100%, even 400% in the past five years. Yes, you read that right—400%. Oh, and by the way: Lewis's portfolio yielded almost $300,000 in income last year. (Overall, it's up 200% in five years.) "I have nothing against America, but there is no value in the market here," the Thousand Oaks (Calif.) resident says.

Investment advisers and finance professors have long urged Americans to be more global, putting as much as half their stock allocation where half the world's public companies are located: outside the U.S. The idea is to profit from economic growth in other nations and to diversify portfolios. So far this year vestments in foreign stock mutual fu have outpaced U.S. funds almost $ $1, according to the Investment Com ny Institute, the fund industry's t group. Of the $8.9 trillion in mutual f assets last year, nearly 11% was stashe foreign securities, up from 8% in 19

But Lewis and others like James F managing director of Sentinel Real Es Corp. in New York, have clearly gon extremes. Pope has put 100% of his figure 401(k) account in a foreign s fund, American Funds EuroPa Growth, prompting his plan admini tor to send him warnings that he's no versified enough. The fund is up an nualized 24% in the past three ye against an 11% gain for the Standa Poor's 500-stock index. "It's hard to gue with those numbers," says F whose firm invests in real estate.

What's turbocharging the return these folks: the persistent weak of the U.S. dollar against a m tude of currencies. In the last years the dollar has fallen against the euro, against the Cana

ALEX NABAUM

; and 8% against the Japanese yen. means stocks denominated in other ncies are worth more dollars, even if the price in euros or yen stays the same.

In fact, if you're practicing this sort of extreme investing, e making a bet on one of two sce- s. Either you're a nimble enough in- r to know when the dollar will gthen, and will hedge or get out l of the turn, or you believe the dol- in a permanent long-term decline, esult of America's seemingly in- able budget and current-account ts. Peter Schiff, president of Euro c Capital, a New York brokerage hat specializes in nondollar invest- s for individual investors, falls into tter category. "We are not sending y abroad because we are looking for Schiff says. "The risk is here in ica. It's in the dollar. We're simply ming too much and not saving gh to pay for it."

ICE ROLL

LE IT'S EASY to be down on the dol- it wise to pass on the U.S.? "If you nvesting for the very long term, it d be inconceivable that you would 0% weighting on the U.S.," says bell Harvey, professor of interna- l business at Duke University's a School of Business. "The U.S. is y dynamic economy, it has done mely well. [Bypassing it totally] d be ill-advised."

t Lewis, and investors like and Lucy Swearingen Chagrin Falls, Ohio, hey are not rolling but in fact choosing relatively conservative investments. "We are investing in companies that are solid and in most cases pay a dividend," says Lucy Swearingen. The couple—he's an architect, she's a nurse—had virtually no money overseas 10 years ago. Today they have more than 90% of their portfolio in foreign securities, including desalinization plants in Singapore and toll roads in China (table).

International, Intriguing

COMPANY/SYMBOL	COUNTRY	BUSINESS	PRICE*	YIELD*	TOTAL RETURN** 1-YR	3-YRS.
STOCKS FOR INCOME						
Shiningbank SHN	Canada	Energy trust	$20.20	13.5%	14.4%	151.3%
Gloucester Coal GCL	Australia	Coal mining	2.60	9.8	13.0	956.6†
Kiwi Income Property Tr. KIP	New Zealand	Property trust	0.87	6.6	21.9	83.7
Wereldhave WHA	Netherlands	Property trust	105.96	6.0	4.5	107.9
Singapore Post SPOST	Singapore	Postal services	0.68	6.8	30.6	135.5
STOCKS FOR GROWTH						
Road King 1098	Hong Kong	Toll roads	$1.17	4.8%	54.7%	108.4%
Hyflux HYF	Singapore	Water purification	1.32	0.5	-43.0	240.6
New Zealand Refining NZR	New Zealand	Oil refining	4.22	7.3	38.5	512.4
Prosafe ASA PRS	Norway	Offshore oil svcs.	59.26	3.4	73.1	282.2
Zinifex ZFX	Australia	Metals mining	8.08	2.9	241.2	476.9††

*July 31, 2006, prices quoted in U.S. dollars, with dividends reinvested **In U.S. dollars †Price from Aug. 19, 2003 ††Price from Apr. 2, 2004
Data: Euro Pacific Capital, Bloomberg Financial Markets

One of Lewis' largest investments is Kiwi Income Property Trust, which has a 6.6% yield. She also holds shares in Harvest Energy Trust, a Canadian owner of oil and gas properties. Other holdings include Santos, an Australian oil and natural gas exploration firm, and various international gold mining concerns.

Lewis and the Swearingens are not out there picking foreign companies alone. They're being guided by Euro Pacific Capital (no relation to American Funds EuroPacific Growth). Though Euro Pacific's president Schiff is a regular CNBC pundit on international investing, both say they came to Euro Pacific via investment newsletters. Schiff, for one, prefers investing directly in stocks on their home exchanges rather than using American depositary receipts, which trade in U.S. dollars, mainly on the New York Stock Exchange. That's because you can invest in fewer than 1,500 companies through ADRs, and they tend to be large and well-known. The real gems, says Schiff, are in the smaller companies that might trade anywhere from the Netherlands to New Zealand.

Placing an order to buy or sell stocks in Amsterdam or Auckland is far more expensive than trading ADRs, which trade like U.S. stocks with U.S. commissions. Charles Schwab, for example, charges as much as $100 per foreign trade vs. a maximum of $12.95 for an online domestic trade. That's not a huge cost for investors who plan to hold those stocks for a long time. But frequent trading in foreign securities could get costly—even if you are earning extreme returns. ■

–With Greg Hafkin

BY GENE G. MARCIAL

CHINA AND EUROPE ARE EAGER FOR WRIGLEY CHEWING GUM.

NORFOLK SOUTHERN RAILROAD IS SET TO OPEN THE THROTTLE.

CONCERNS ABOUT RADIATION THERAPY WERE "OVERBLOWN."

Juicier at Wrigley

DESPITE WM. WRIGLEY JR.'s (WWY) 60% share of the U.S. chewing gum market, analysts' concerns about competition have been a drag on the stock. But on July 25, shares jumped from 43 to 45 when the company announced that second-quarter sales of gum, including Juicy Fruit and Spearmint, had gone up 3%, vs. flat-to-down forecasts. Wrigley's overall sales soared 16%, to a record $1.2 billion, while worldwide shipments jumped 8%. The momentum should continue, says Michael Schwartzman, president of ValueSearch Capital Management, which owns shares. "Excellent opportunities in Europe and China make this well-managed company a buy, particularly for long-term investors," he says. Wrigley provides "good returns and small risks," adds Schwartzman, who expects the stock to reach 80 in four years. Last year's purchase of Kraft Foods' Altoids and LifeSavers brands should boost Wrigley's earnings, he says, although for now they have cut into profit margins. "Unlike some analysts, we believe gum has growth potential," says Eric Katzman of Deutsche Bank, who rates the stock a "buy." Wrigley, he says, will use its global network to promote Altoids and LifeSavers. The stock is cheap, argues George Askew of investment bank Stifel Nicolaus. Trading at 19.7 times his 2007 profit estimate of $2.23 a share, the stock is an attractive value for long-term investors, he says. For 2006, Askew expects $2.03, vs. 2005's $1.93. His 12-month price target for the stock, now at 46.03, is 58.

A LITLE DIP IN FLAVOR

Data: Bloomberg Financial Markets

All Aboard Norfolk Southern

NORFOLK SOUTHERN (NSC) had been on a fast track since 2003, racing from 24 to 57 in mid-May, 2006. But the fourth-largest U.S. railroad skidded when second-quarter operating earnings missed analysts' forecasts because of reduced tax credits. The stock fell 10%, to 41, on July 26. "The market's reaction was overdone," says Carl Birkelbach of Birkelbach Capital Management, which bought shares at 39.46. They have since edged up to 42.81. Trading at 12 times his 2007 profit forecast, Norfolk "is a heck of a bargain," says Birkelbach. The stock, he figures, should hit 54 in a year. Kevin Kirkeby of Standard & Poor's upgraded Norfolk from "hold" to "buy." Norfolk's volume growth, led by container and coal shipments, is expected to continue into 2007, he says, while better use of its assets should boost margins. Kirkeby sees Norfolk to earning $3.44 a share in 2006 and $3.91 in 2007, up from $3.11 in 2005. Thomas Wadewitz of JPMorgan Securities says Norfolk's valuation is "compelling" now that it's trading below its historical range of 11 to 15 times forward earnings.

DOWN A STEEP GRADE

Data: Bloomberg Financial M

A Good Prognosis For Radiation Therapy

ALTHOUGH IT HAS TREATED CANCER patients for years, Radiation Therapy Services (RTSX) is not yet most institutional investors' radar. The stock hit 39 December but is now at 28.69, driven down by fears that s Medicare reimbursements could be slashed. In June, howe the federal agency that administers Medicare and Medicai issued new fee schedules that would eventually lift RTSX revenues for services that it provides, from conventional treatment by beams of radiation to advanced prostate seed implants. Fees will drop 1% in 2007, but will rise 1% in each year from 2008 to 2010. This has "alleviated overblown concerns of sharp and drastic cuts in reimbursements," says Randall Scherago of First Albany Capital. He has a 12-month target of 35 based on his forecasts of $1.31 a share for 2006 on revenues of $278 million and $1.52 for 2007 on $310 million, vs. $1.06 in 2005 on $227.3 million. Brooks O'Neil of Avondale Partne says the stock's drop provides a chance to buy into a $7 bil a-year market where 60% of cases are treated with radiatic RTSX expects to boost revenues at each of its 70 centers in states and plans to open more, he says. ■

JITTERS ABO MEDICARE FE

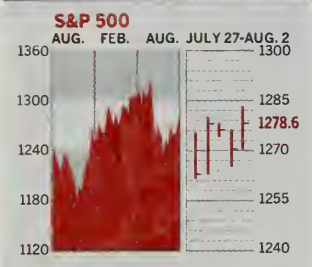
Data: Bloomberg Financial

BusinessWeek online Gene Marcial's Inside Wall Street is poste businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor firms hold positions in the stocks under discussion. Similarly, they have no invest banking or other financial relationships with them.

BARNYARD
Only In Theaters
Aaron Parry
Executive Producer
Paramount Pictures
Julia Pistor
Executive Producer
Nickelodeon Movies
Mike Braico
Account Executive
Sun
Steve Oedekerk
Writer/Director/
Producer
Omation
Anthony Lopez
Lead Systems
Administrator
Omation
Otis
Movie Star
Share the creative process. Paramount Pictures, Nickelodeon Movies and Omation Animation Studios brought top industry talent together for the production of their animated film Barnyard. As the artists began the intensive process of 3D rendering, they realized that their infrastructure could use a helping hand. Enter the powerful x64 servers from Sun. With the time and resources they saved, the rendering of the movie was completed in 6 months—warp speed in the animated-film business. The results are extraordinary. The power is the collaboration. The network is the computer.™ Share.
sun.com/x64
Sun microsystems
AMD 64 Opteron
share

STOCKS



COMMENTARY

The markets were desultory last week, with the major indexes gyrating wildly before finishing less than a percentage point from where they began. Strong earnings results sent Procter & Gamble's stock up 4%, while Starbucks missed its sales estimates and shed 8%. Interest rates will be on traders' minds leading up to the next meeting of Fed policymakers on Aug. 8.

Data: Bloomberg Financial Markets, Reuters

U.S. MARKETS	AUG. 2	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1278.6	0.8	2.4	2.8
Dow Jones Industrials	11,199.9	0.9	4.5	4.8
NASDAQ Composite	2078.8	0.4	-5.7	-6.3
S&P MidCap 400	741.2	0.6	0.4	2.2
S&P SmallCap 600	361.0	0.5	2.9	0.9
DJ Wilshire 5000	12,788.4	0.7	2.3	2.8
SECTORS				
BusinessWeek 50*	717.8	0.2	-3.2	-3.3
BW Info Tech 100**	370.2	1.6	-2.7	-0.9
S&P/Citigroup Growth	588.3	0.6	-1.4	-1.5
S&P/Citigroup Value	688.9	1.0	6.4	7.3
S&P Energy	444.0	1.5	19.1	19.4
S&P Financials	443.6	0.9	4.0	9.7
S&P REIT	173.9	0.1	13.7	8.0
S&P Transportation	244.0	0.7	-2.3	8.9
S&P Utilities	173.4	0.4	8.6	5.0
GSTI Internet	156.3	2.1	-23.8	-13.1
PSE Technology	770.1	1.9	-7.9	-5.2

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	AUG. 2	WEEK	% CHANG YEAR TO DATE	L M
S&P Euro Plus (U.S. Dollar)	1707.6	3.0	13.0	
London (FT-SE 100)	5932.1	0.9	5.6	
Paris (CAC 40)	5026.3	1.7	6.6	
Frankfurt (DAX)	5680.8	1.8	5.0	
Tokyo (NIKKEI 225)	15,464.3	3.9	-4.0	
Hong Kong (Hang Seng)	17,032.8	2.5	14.5	
Toronto (S&P/TSX Composite)	11,969.9	0.8	6.2	
Mexico City (IPC)	20,145.1	1.2	13.2	

FUNDAMENTALS	AUG.1	WEEK AGO	YE
S&P 500 Dividend Yield	1.85%	1.88%	1
S&P 500 P/E Ratio (Trailing 12 mos.)	16.8	16.7	1
S&P 500 P/E Ratio (Next 12 mos.)*	13.9	13.9	1
First Call Earnings Surprise*	5.28%	4.66%	4

*First Ca

TECHNICAL INDICATORS	AUG.1	WEEK AGO	R
S&P 500 200-day average	1267.6	1265.4	Po
Stocks above 200-day average	50.0%	50.0%	Ne
Options: Put/call ratio	0.90	0.85	Po
Insiders: Vickers NYSE Sell/buy ratio	2.52	2.63	Ne

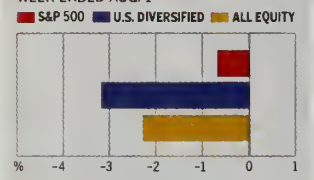
BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Home Entertainment	16.2	Agricultural Products	95.4
Gas Utilities	11.9	Steel	74.6
Health-Care Equip.	9.4	Divsfd. Metals & Mining	58.5
Tobacco	9.1	Oil & Gas Refining	45.6
Health-Care Facilities	8.7	Gold Mining	38.4

WORST-PERFORMING GROUPS	LAST MONTH %		M
Internet Retail	-32.6	Internet Retailers	
IT Consulting	-19.6	Homebuilding	
Photographic Products	-17.5	Educational Services	
Trading Cos. & Distribs.	-17.1	Tires & Rubber	
Internet Software	-16.4	Home Furnishings Rtlrs.	

MUTUAL FUNDS

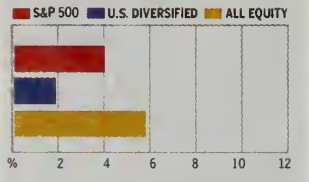
4-WEEK TOTAL RETURN

WEEK ENDED AUG. 1



52-WEEK TOTAL RETURN

WEEK ENDED AUG. 1



Data: Standard & Poor's

EQUITY FUND CATEGORIES 4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
Utilities	4.0	Precious Metals	70.8
Real Estate	1.2	Latin America	42.5
Health	0.9	Japan	25.6
Large-cap Value	-0.2	Diversified Emrg. Mkts.	25.5
LAGGARDS		LAGGARDS	
Technology	-7.8	Technology	-5.8
Small-cap Growth	-7.3	Large-cap Growth	-1.6
Mid-cap Growth	-6.2	Small-cap Growth	-1.5
Small-cap Blend	-4.8	Mid-cap Growth	-0.3

EQUITY FUNDS 4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEADERS		LEADERS	
DireXn. NASDAQ 100 Br. 2.5X Inv.	18.1	U.S. Global Invrs. Gold	106.8
ProFunds UltSh. OTC Inv.	14.3	Midas	105.0
Rydex Inv. Dynmc. OTC H	14.1	U.S. Glbl. Invs. Prc. Mnls.	98.5
DireXn. Sm. Cap Br. 2.5X Inv.	13.8	Van Eck Invrs. Gold A.	90.1
LAGGARDS		LAGGARDS	
American Heritage Grth.	-25.0	Ameritor Investment	-75.0
ProFunds Internet Inv.	-18.2	American Heritage Grth.	-50.0
DireXn. NASDAQ 100 Bl. 2.5X Inv.	-17.7	ProFunds. Semicdr. Inv.	-32.0
iShares Gold. Sachs Nwkg.	-15.8	Alpine U.S. Rl. Est. Eq. Y	-26.6

INTEREST RATES

KEY RATES	AUG.2	WEEK AGO	YE
Money Market Funds	4.80%	4.78%	2
90-Day Treasury Bills	5.11	5.10	3
2-Year Treasury Notes	4.95	5.07	4
10-Year Treasury Notes	4.97	5.03	4
30-Year Treasury Bonds	5.05	5.10	4
30-Year Fixed Mortgage †	6.46	6.54	6

†BanxQuot

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR.
General Obligations	4.04%	
Taxable Equivalent	5.77	
Insured Revenue Bonds	4.12	
Taxable Equivalent	5.89	

THE WEEK AHEAD

INSTALLMENT CREDIT *Monday, Aug. 7, 3 p.m. EDT* » In June consumers probably took on $4 billion more of debt, after a May rise of $4.4 billion. That's the median forecast of economists polled by Action Economics.

PRODUCTIVITY & COSTS *Tuesday, Aug. 8, 8:30 a.m. EDT* » Gains in output per hour worked probably cooled to a 1.6% annualized rate in the second quarter, after a 3.7% rise in the first period. Unit labor costs likely grew 3.3%, following a 1.6% gain.

FOMC MEETING *Tuesday, Aug. 8, 9 a.m. EDT* » The Federal Reserve's Open Market Committee meets to discuss monetary policy. A narrow majority of economists surveyed by Action Economics expect the Fed will hold interest rates at 5.25%.

INTERNATIONAL TRADE *Thursday, Aug. 10, 8:30 a.m. EDT* » The foreign trade deficit is expected to have widened slightly, to $64 billion in June.

RETAIL SALES *Friday, Aug. 11, 8:30 a.m. EDT* » Retail sales probably grew 0.5% in July, after slipping 0.1% in June. Excluding autos, July sales likely increased by 0.4%, after a 0.3% rise.

EXPORT-IMPORT PRICES *Friday, Aug. 11, 8:30 a.m. EDT* » July export prices are forecast to have climbed 0.3%, while import prices most likely jumped 0.8%.

The *BusinessWeek* production rose to 285.1 for the week ende 22, a 12.9% increase from a yea Before calculation of the four- moving average, the index dec to 284.4.

BusinessWeek on

For the BW50, more investm data, and the components of the production index visit www.businessweek.com/extras

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PLAYBOOK: BEST-PRACTICE IDEAS

Formula for Failure

innovation's great paradox: Success—that is, true breakthroughs—usually comes through failure. w to help your team get comfortable with taking risks and learning from their mistakes.

EPIC CHANGE Corning's new system uses light waves to test new drugs

Formalize Forums For Failure

To keep failures and the valuable lessons they offer from getting swept under the rug, **carve out time for reflection.** GE has recently begun sharing lessons from failures by bringing together managers whose "Imagination Breakthrough" efforts are put on the shelf.

Move The Goalposts

Innovation requires flexibility in meeting goals, since early predictions are often little more than educated guesses. Intuit's Scott Cook even suggests that teams developing new products ignore forecasts in the early days. "For every one of our failures, we had spreadsheets that looked awesome," he says.

Share Personal Stories

If employees hear leaders discussing their own failures, **they'll feel more comfortable talking about their own.** But it's not just the CEO's job—front-line leaders are even more important, says Harvard Business School professor Amy Edmondson. "That person needs to be inviting, curious, and the first to say: 'I made a mistake.' "

Bring In Outsiders

Outsiders can **help neutralize the emotions and biases that prop up a flop.** Customers can be the most valuable. After its DNA chip failed, Corning brought pharma companies in early to test its new drug-discovery technology, Epic.

Prove Yourself Wrong, Not Right

The tend... ...ory for develo...ment teams ... rather ... eviden... what y... days," ... Anthon... **seekin... right ...** testin...

Cele... Sma...

Mana... perfo... syste... and f... But t... **failur... new,** and o...

PLAYBOOK: BEST-PRACTICE IDEAS

The Pause that Refreshes

Companies that pamper veteran employees with paid sabbaticals include:

CHARLES SCHWAB
Four weeks at every five years of employment. Employees need supervisors' O.K. to take time off.

EILEEN FISHER
One week at every 10 years of employment. Employees also get $5,000 that must be spent during their bonus vacation.

HEWITT ASSOCIATES
One week off for every five years of employment, maxing out at three weeks. Part-timers qualify, too.

INTEL
Eight weeks at every seven years of employment. Employees also receive up to four weeks of paid vacation each year.

McDONALD'S
Eight weeks at every 10 years of employment. Starting next year, employees will get an extra week off on the "fives," too.

MORNINGSTAR
Six weeks at every four years of employment. Its trigger anniversary is among the earliest of the corporations surveyed.

Need advice? Our editors compile t practice ideas and tip sheets by topic at **businessweek.com/playbook/**

BusinessWeek

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Notebook Review: Portable and powerful, how to shop for this increasingly popular type of computer.

Take That Vacation: The health – and career – risks of missing out on your time off.

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Company Index

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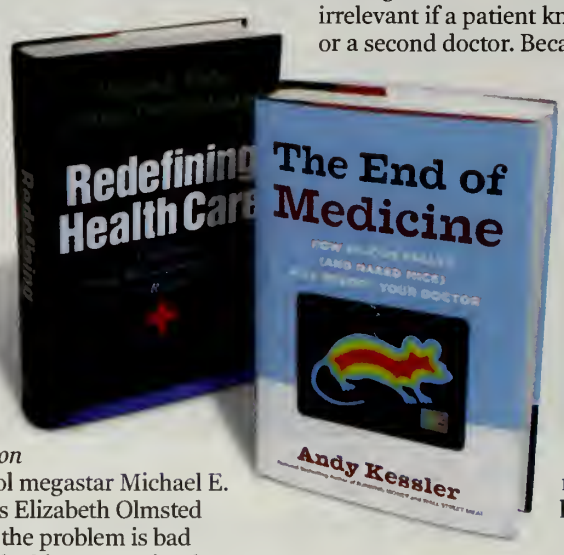
Business, Heal Health Care

THE END OF MEDICINE How Silicon Valley (and Naked Mice) Will Reboot Your Doctor
By Andy Kessler; Collins; 354pp; $24.95

REDEFINING HEALTH CARE Creating Value-Based Competition on Results
By Michael E. Porter and Elizabeth Olmsted Teisberg; Harvard Business School Press; 506pp; $35

It's no secret how messy the U.S. health-care industry is. Americans spend 16% of gross domestic product on health care, but quality is poor. Medical mistakes are the nation's third-leading killer, yet bad doctors and hospitals rarely go out of business. Most amazingly, innovation is insanely slow: The average time between discovery of a medical innovation and wide adoption is 17 years.

But what to do about it? Two books recommend solutions that reflect their authors' backgrounds. In *The End of Medicine: How Silicon Valley (and Naked Mice) Will Reboot Your Doctor*, former tech financier Andy Kessler says the solution is better technology—specifically, imaging and diagnostics that catch disease sooner. He would replace many doctors and nurses with cheap, reusable scanners and chips just as banks zapped tellers with ATM machines. In *Redefining Health Care: Creating Value-Based Competition on Results* by Harvard Business School megastar Michael E. Porter and the University of Virginia's Elizabeth Olmsted Teisberg, two management profs say the problem is bad management. Patients, doctors, and the big companies that pay for most private insurance don't know how to measure health-care quality and value, so they slash coverage to cut costs, the authors say. Each book shows part of the way to better care, at prices that, if not falling, at least don't grow at this decade's double-digit rates.



Of the two volumes, Kessler's is by far the more entertaining. It's a smart-aleck tour of academic labs where Kessler says the future is being invented. Think *Bill & Ted's Excellent Adventure* meets *The New England Journal of Medicine*. Kessler, an ex-semiconductor analyst and hedge fund partner, interviews researchers refining cardiology scanners and others trying to build cheap, reliable genetic tests and biomarker assays to find cancer. Kessler insists that we can dent the $400 billion-a-year bill for heart disease and cancer if we spot problems sooner. He admits his revolution will take years and that new diagnostics will initially cost a lot. But he insists Silicon Valley's innovation-financing machine will pony up billions to make sure the change spreads and drives down unit costs as better science emer

The smart part of Kessler tells us about scanners that ca parse hearts in minute detail, while his silly side goes on ab mouse poop and his own virtual colonoscopy. We are spoo biology, but the science may still lose some readers. There a also evocative profiles of people such as Don Listwin, a Cisc Systems Inc. zillionaire whose mother's death from cancer prompted him to pour his fortune into diagnostics researc

If Kessler's book is more fun, Porter and Teisberg's wor volume is more important. They see an interrelated lack o technology and information that blocks real competition. Having 10 doctors or four hospitals vie for business is irrelevant if a patient knows only anecdotes from a neighl or a second doctor. Because of that ignorance, providers compete based on location or amenities such as designer hosp gowns. The authors push for th spread of nascent databases tha track both prices and health outcomes, so consumers can kn who gives value for the dollar.

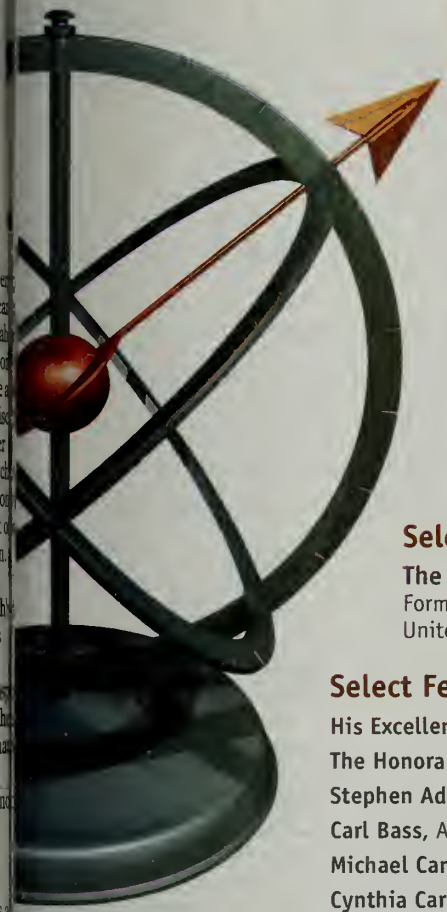
Porter and Teisberg say real innovation will come when consumers and their employers a on this data. Companies must bu health plans based on value, broa defined, rather than settling for l rates or hiking deductibles, the authors argue. And employers mu make sure workers can access ser like HealthShare or Subimo that r providers. Then companies should give employees incent for adopting healthy lifestyle going into disease-managem programs, or switching to to providers. Most provocatively authors say business should top executives, not mid-level managers, in charge of benef then judge them not only by cuts but also by advances in workers' health and producti

The authors don't believe Washington has the answers

The most interesting thing both books is what they don't say: Neither believes Washin holds much of the answer to what ails health care. Instead, demand that business solve the problem. And time is short winner of the next Presidential election could serve until 20 and the Medicare trust fund is expected to go broke in 2018 business thinks there's time to waste, business is wrong.

–By Timothy J. Mu

BusinessWeek events



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BY NANCY KILLEFER AND LENNY MENDONCA

Unproductive Uncle Sam

The past decade has been one of America's finest in terms of productivity growth. Yet a crucial 20% of our economy appears to have been left behind: government. Despite numerous attempts at management reform and a panoply of opportunities to transfer best practices between the private and public sectors, government seems to have missed out on the productivity boom seen in the private sector. That's a shame, because while there are important differences between the public and private sectors, government does an abundance of grantmaking, procurement, property management, customer service, and other jobs ripe for productivity improvement.

So just how far behind is government? We can't say with any certainty because the Bureau of Labor Statistics, which used to measure its productivity, stopped in 1996. Our analysis shows that government kept up with the private sector until 1987, when a gap emerged. It went on widening until 1994, when the data ran out. We believe it has widened further still.

This public productivity deficit couldn't come at a worse moment. Americans today say they want to limit the cost of government, but they also want more homeland security, better-managed borders, more disaster readiness, extra help in the face of global trade, cheaper health care, and better public schools. These demands sit uncomfortably with our budget deficit and our natural desire not to pay more taxes. In short, we are stuck in a productivity bind: We want more output but no more input.

In a white paper our firm, McKinsey & Co., published this week, "How Can American Government Meet Its Productivity Challenge?", we map out an agenda inspired by lessons from the private sector. Having studied productivity growth around the world for over 15 years, the McKinsey Global Institute has shown that competitive intensity at the industry sector level is the prime catalyst for productivity growth. It forces managers to improve performance and allows innovation to diffuse quickly across the sector.

Make no mistake, government is a sector—structured and regulated in ways that can foster or stunt productivity growth at its "firms" (agencies). And while it may not be possible to use competition in government to exert pressure to perform, Congress and the White House or state legislators and governors have plenty of tools to improve public agencies.

To boost performance, government needs to measure and set targets for its programs

The most natural tool is the budget process, but the rea in Washington and many state capitals is that performanc remains a secondary factor in budget decision-making. Congressmen fight for their district or their passions, and accordingly, agencies privately admit that you budget for what you can get, not what you need or deserve. Yet when government performance, or the lack thereof, is highly vis (witness the response after Katrina), everyone takes actio

That's why we think a radical new approach to transparency of how government programs are performin required. Only this will push Congress to exert performan pressure on government agencies. First, government shou measure public productivity again and set national targets for productivity growth agai which everyone can be held accountable. Ne political leaders should create a body we call "Gov-Star," modeled after fund-rating agen Morningstar Inc., to provide completely independent measurement of government program performance; to develop comparab program data over time—between programs between governments, and with the private sector; and to make the data and their implications clear to appropriators and citiz

But in government, pressure without supp can yield demoralization and underperform So we also need to adopt key transformation initiatives: incentives that allow agencies to reinvest savings to the top line of programs; the introduc of chief operating officers at public agencies, to be appoin based on management experience in government or lead corporations; and a SWAT team of management experts a Office of Management & Budget to help lagging agencies

It's a long list. But if we want our government to do m and do better, we must take public management and productivity more seriously. Otherwise, citizen demands effective government in the future will go unheeded. ■

Nancy Killefer, *a senior partner at McKinsey & Co., is former Assistant Treasury Secretary for Management.* **Lenny Mendo** *is a senior partner and chairman of the McKinsey Global Inst*

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Ideas The Welch Way

BY JACK AND SUZY WELCH

Pick Your Poison Wisely

What's better, to work for a bad boss at a good company or a good boss at a weak company?

–Anonymous, Chicago

We've gotten this question several times while traveling around the world, and we have been amazed at how split audiences seem on the answer. Amazed, because to us this is an absolute no-brainer. If you have to pick between these options, by all means, work for the good company!

Here's our reasoning. If you are at a truly good company, its leaders will eventually find and dispatch the bad boss. That can take time—months, or even a year or more. In that case, you might even be rewarded with a promotion for having delivered results during your ordeal. After all, everyone has been there at some point in his or her career, toiling for some turkey who's moody, mean, or just plain incompetent.

But even if you're not promoted for your "hardship duty," you will still be better off for having endured a boss from hell. You will be able to stay where you are in the good company with a new and better superior or move sideways to a fresh opportunity. Remember: Any experience you get at a good company where you're working with smart people is worthwhile, and a stint at a company with a sterling reputation gives you an excellent career credential down the road, if you need it.

Now think about the other scenario. Without question, having a good boss is one of life's best experiences. Good bosses can make work fun, meaningful, and all those warm, fuzzy things. Good bosses can make work feel like a home away from home. They can make your team feel like a family. In some cases, they can even make you feel like you've found a long lost friend or finally gotten "parental" approval.

> Enduring a bad boss can eventually enhance your career, but staying with a good boss at a bad company is nothing but a velvet coffin

But the good boss-weak company dynamic is a velvet coffin. All bosses eventually depart. They move up, out, or sideways. And someday your good boss will leave you, too. In fact, good bosses in weak companies are especially vulnerable to change because they have the extra stress of "protecting" their people from the impact of the organization's larger problems. This burden can wear th out or make them political pariahs, or both. Either way, i time they go.

In some ways, this question comes down to a choice between short- and long-term gains. In the short term, working for a bad boss, even in a good company, can be a nightmare. But in the long term, when the bad boss is go at least you'll have the opportunity to move on.

Working for a good boss in the short term can be thoroughly enjoyable even when the company is collapsi around you. Long-term, however, those happy vibes will back to haunt you. When your boss makes a beeline for t exit, you'll be trapped. Getting a new job after you've wor at a company with a mediocre or poor reputation is hard. almost as if you're tainted. So all you'll have is a second-r credential and nice memories.

Do your career a favor and get your memories elsewhe

Is there a short answer for building trust in the workplace?

–Shaffee Suleman, Johanne

Yes, very short: Say what you mean and do what you say.

Look, trust fritters and dies two ways. First, when peo aren't candid with one another. When they sugarcoat tou messages. When they use jargon and baloney to purpose make matters obscure and themselves less accountable. T only way to get candor into an organization is for the bos to identify it as a top value, consistently demonstrate it themselves, and reward those who follow their lead.

The second trust-killer is when people say one thing a another. Again, bosses are the main culprits. They tell pe to take risks but nail them when they fail. They endorse stretch budgets and invite their people to dream big, ther punish them if the numbers fall short, even at the end of decent year. They proclaim a commitment to customer se and let the factory ship less-than-perfect product to make month's sales quota. Or worst of all, they espouse the company's values at the top of their lungs but keep and reward people who don't live according to those values si because they make the numbers. The message that sends the organization is: Nothing I say means anything. Don't trust me.

Trust, ultimately, isn't very complicated. It's earned through words and actions instilled with integrity. ■

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at **thewelchway@businessweek.com.** *For their weekly podcast, go to www.businessweek.com/search/podcasting.htm*

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What Makes A Winner

THE COMPETITION ISSUE

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» How people, organizations, and communities get ahead

» Joe Torre, Steve Ballmer, Anne Mulcahy, & others on winning

» Poll: How competitive are you?

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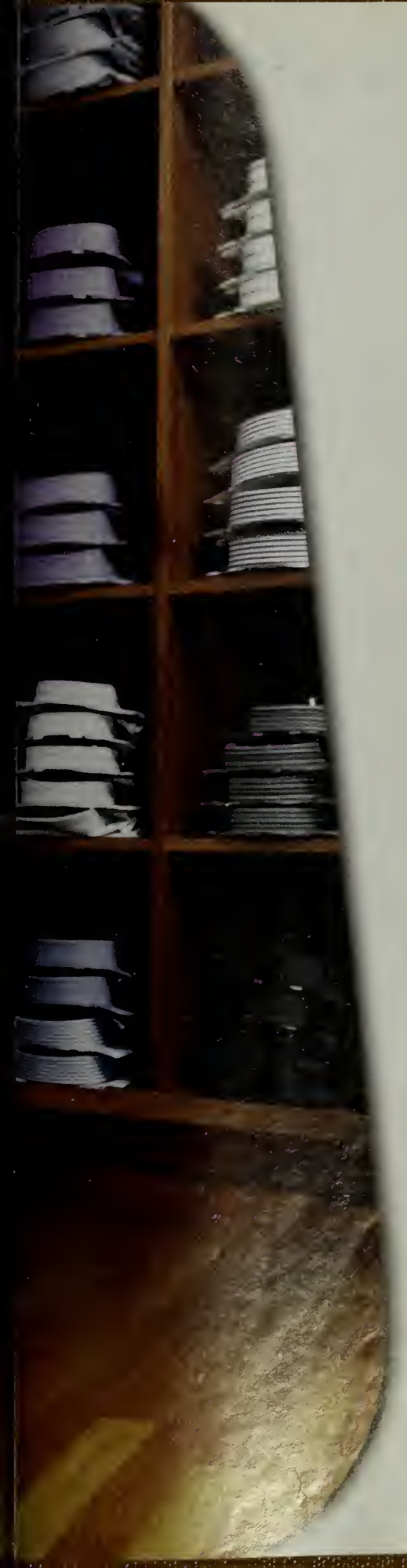

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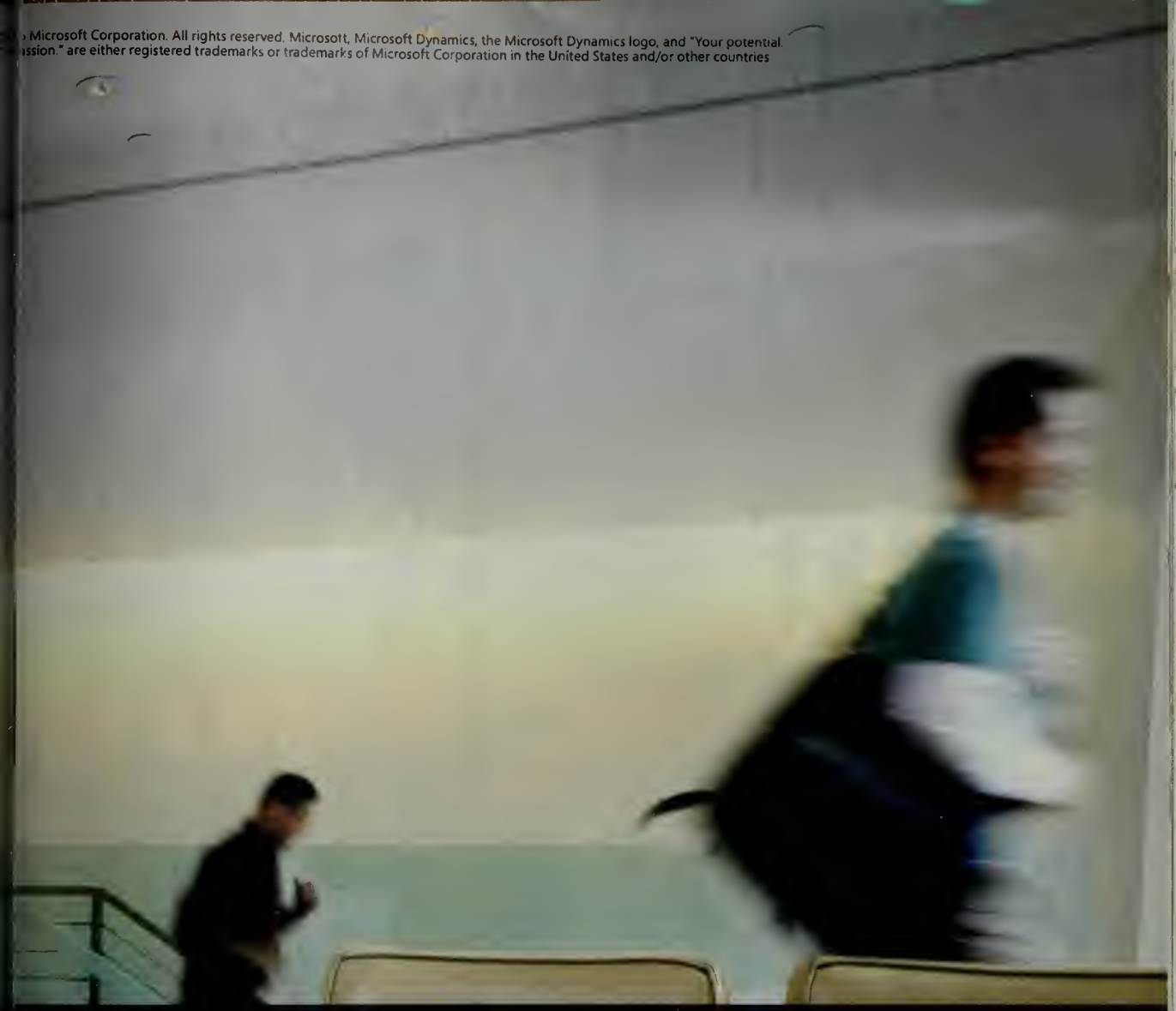

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BusinessWeek

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When it came to our tasting of "white goods," the superpremiums ruled the day. Here, our top three in each category, plus our tasters' comments:

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Compete with Confidence

Oracle CEO Larry Ellison's mega yacht, Rising Sun

A simple $60 million wedding? A modest 454-foot yacht? Check out BusinessWeek.com's slide show—part of our online Special Report on competition—to see these and other examples of the ultracompetitive sport of **extreme consumption.** Of course, not everyone is (or can afford to be) so brazenly confident. In fact, wh it comes to **the competitive arena,** few battles are more intense than the inner war some wage against themselves. For those who aim surmount internal conflicts, we offer tools to help hone skills and tales to inspire. You say you eat nails for breakfast? Well, you may not be alone. **Take our poll** on the state of competition in America to see if you're among the minority who would rather get management advice from the likes of Tony Soprano than Peter Drucker. How do some of the world's top achievers maintain their edge? Pick up tips from our slide show featuring the **personal reflections** of Richard Branson, Rupert Murdoch, and Katie Couric, among others. Microsoft CEO Steve Ballmer has a reputation for being a fierce competitor. Read our interview with him to learn who stands out as **the toughest riva** he has ever faced. For some, competition starts at an early age. Vi a music camp to see how talented young musicians train. For the features and more go to: **www.businessweek.com/extras**

A pianist honing his skills at t Meadowmount School of Mu

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JP Front

"It's my whole personal life. I had no idea somebody was looking over my shoulder."

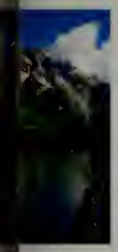
–Thelma Arnold of Liliburn, Ga., aka AOL user No. 4417749, quoted in The New York Times, *after AOL, to its regret, released search-query data on the Internet*

D BY DEBORAH STEAD

ECONOMY

OIL, ET BIG DERNESS

AIL MIX SET has been ning numbers to prove g enough to take on Big a study to be released on Aug. 11, the **Outdoor Industry Assn.** says outfitters and related companies generated $289 billion in retail sales last year, supporting more jobs **Wal-Mart Stores** does and buting $730 billion to onomy.



NG
Teton
nal Park

The organization, whose members include apparel giant **Columbia Sportswear,** adventure gear retailer **REI,** and thousands of small outfitters, wants to leverage its economic clout with federal policymakers, who are increasingly requiring campers, hunters, and climbers to share wilderness areas with oil and gas drillers. The idea is to put an economic spin on the urgency of preserving these areas. "We hope to provide tangible evidence of how important these assets are to the business economy," says Sally Jewell, CEO of REI, based in Kent, Wash. It won't be a walk in the park. The trade group, based in Boulder, Colo., spent less than $300,000 lobbying last year, a far cry from the $28 million spent by oil and gas interests. *–Lorraine Woellert*

BIG PICTURE

FALL will bring a bumper crop usiness books, according to nes & Noble. Close to 40 are to be published from Septem- to December, including quite a biographies. Here, a partial list:

rew Carnegie by David Nasaw (Penguin Group)

y Grove: The Life and Times of an American hard S. Tedlow (Penguin Group)

z: Computer Geek to Cult Icon—Getting to the f Apple's Inventor by Steve Wozniak, with Smith (Norton)

Real Deal: My Life in Business and Philanthropy ndy Weill and Judah S. Kraushaar er Business)

gh Choices: A Memoir by Carly Fiorina uin Group)

INTELLIGENCE

In the Dark about Outside Snoops

FIVE YEARS AFTER the September 11 attacks, the U.S. intelligence community has so many outside contractors working for it that the government doesn't know the exact number. Nor does the top brass know exactly what all these companies are doing. (Such work can include everything from threat analysis to translation services.) This summer, staffers at the **Office of the Director of National Intelligence,** which briefs the President daily, began taking an inventory. "We're trying to identify those contractors who are doing core intelligence work," says a senior intelligence official. Up to now, he says, there wasn't "a good way of counting them or identifying what kind of work they're doing."

Officials say the results of the survey, to be collected from the various intelligence agencies by Labor Day, will help determine if these private contractors are wasting taxpayer dollars—through duplication, improprieties, or by using high salaries to recruit top talent away from government, in effect forcing Washington to pay more for expertise. The headcount is long overdue, says Keith Ashdown, vice-president of **Taxpayers for Common Sense.** "It's just ridiculous," he says. "We should have known this years ago." *–Eamon Javers*

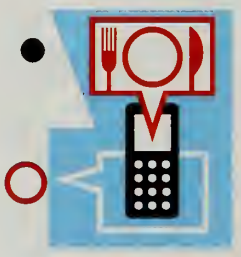
UPFront

MOBILE WEB

NO PC? NO MOUSE? SURF'S UP!

MIKE McCUE, co-founder of **Tellme Networks,** has been waiting a long time to help the masses navigate the Web via spoken words rather than with a PC and a browser. When he started Tellme in 1999, he called this idea DialTone 2.0. Then came the dot-com bust, and Tellme switched its focus to businesses. Today, when you call **American Airlines** or **Verizon,** you hear Tellme's voice-automation system.

Now, thanks to mobile-phone technology, McCue's longheld idea may soon be a reality. Tellme is now working with **Microsoft** and **Cingular Wireless,** among others, to create mobile search services—a way for folks in motion to find information on people, businesses, or other subjects.



A hungry traveler, for instance, might simply say "restaurants," "sushi," and "downtown" into his cell phone and quickly get a readout of listings, reviews, and maps. "We have a vast array of content. Tellme has great expertise in voice applications," says John DeVitis, product unit manager for **Windows Live Mobile Search.**

Industry analysts believe voice technology is ripe for these uses. Says Seamus McAteer of research firm **M:Metrics:** "Your voice can be the mouse of the mobile phone." *–Steve Hamm*

CHEAP CHIC

MARBURY i Starbury O

FED UP with the high prices urban kids pay for sneakers marketed by their basketball heroes, New York Knicks point guard Stephon Marbury is launching the Starbury One, a $14.98 sneaker he'll wear on the court. Discount retailer Steve & Barry's will make and sell the shoe, which is 1/12 the price of Nike's $180 Air Jordan XX1. "Two hundred to buy a pair of sneakers," Marbury says, "that's groceries for the week." He wants Starbury One's low price to show kids how lit costs to make a high-quality sneaker. "Histor going to say Stephon Marbury changed the game," he says. *–Robert Be*

BLOGSPOTTING

DESIGN-MINDED

metacool.typepad.com

» WHY READ IT: Diego Rodriguez' design blog, Metacool, has everything most business blogs lack: wit, fresh insights, and, with a few well-disclosed exceptions, posts that promote his ideas instead of the company he works for (in this case, design firm IDEO).

Rodriguez, who also teaches at Stanford University's design school (and who has written for BusinessWeek.com), has been blogging of late on the meaning of authenticity in branding, on brainstorming, and on "unabashed gearhead gnarlyness," his design-geek ode to cool engines and cooler cars.

–Jena McGregor

DOG DAYS

A FRANK LOOK AT THE ECONOMY

Corporate chiefs and economists don't toss around the word "recession" lightly—bad for morale. But New York hot dog chain **Gray's Papaya,** the 24-hour eatery frequented by bag ladies and bankers alike, isn't bashful. Word is that the highly visible outpost on New York's Upper West Side is about to plaster a sign for its "recession special" in its huge front windows. The last time it did that was March, 2001, just as the economy was dipping into recession. The **National Bureau of Economic Research,** which officially calls business cycle turns, reported that March onset eight months later.

Already, perhaps seeing economic clouds (and an interior "recession special" sign left over from past downturns), more Gray's customers are asking for the dog deal ($2.75 for two franks and a drink, inclu tax). "People are getting more realistic and adju their expectations and budgets," says Jackie Schwimmer, a senior vice-president at one of th city's largest real estate brokers, in between cho She doesn't see an imminent full-blown recessi but concedes a pinch in the housing market. Th there's the Wall Street guy who'd ventured upto for his frank fix. Times a good in his neck of the woods, he admits, but h feeling less inclined to d $11 on a Financial Distri designer salad more tha twice a week. And he'd g trade the savory bliss of Gray's recession special added job security. "I lov dogs, and I love the deal says, "but I hope they're wrong." *–Roben F*

GRAY'S Is it about to call a downturn?

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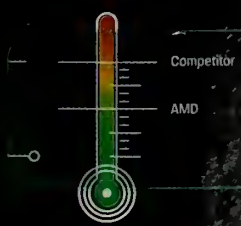

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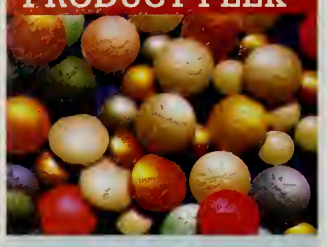

TAKING A SHINE TO YOUR RX

Tired of your little white or blue pills? The FDA recently ruled that drugmakers can start coating pills and tablets with pearlescent pigments similar to those used in cosmetics—sparkly, metallic, or satiny finishes. Called Candurin Pearl Effect Colors, the pigments are made by EMD Chemicals, a unit of Germany's Merck KGaA (no relation to Merck & Co.). EMD hopes pharma companies will use the pigments to distinguish their pills from generics.

The FDA approval has its critics. Those shiny colors are made by coating mica with titanium oxide or iron oxide. The concern is that the iron in the pigment could be toxic, especially for people who must limit their iron intake. But the agency concluded that the pigments, which cannot make up more than 3% of the weight of a drug, would have "no toxic potential" when ingested at that level. Similar pigments have long been used in contact lenses and titanium oxide is already allowed in drugs.

EMD will begin marketing the pigments shortly, raising the possibility that some drugs will look psychedelic, even when they're not.

–Catherine Arnst

THE MESSAGE

LOTS OF QUESTIONS FOR DR. Z

IT TOOK considerable prodding to get **DaimlerChrysler** CEO Dieter Zetsche to agree to the company's "Ask Dr. Z" ad campaign, which kicked off on July 1 to coincide with Chrysler's summer employee-pricing sale. He relented, Zetsche says, only because appearing in the TV, radio, print, and Internet ads seemed slightly more dignified than the alternative offered by Chrysler CEO Tom LaSorda and marketing chief Joe Eberhardt: representing him with just a disembodied graphic of his cookie-duster mustache. "I told them that I wasn't going to be reduced to a bit of hair," he recalls.

It's too soon to gauge the impact of the $100 million campaign, created by ad shop **BBDO**, which aims to show the benefits of a merger that made siblings of Mercedes-Benz and Chrysler. The askdrz.com Web site has had millions of hits, and visits to Chrysler, Jeep, and Dodge Web sites are up 10%, Chrysler says, with requests for information or a test drive up 30%. Overall July sales, including to rental fleets, are down 37% from last summer's levels (admittedly so high they make comparisons tough) and down 21% from this past June. But July retail sales were up 9% over June.

» THE BRAND Chrysler **» THE SHOP** BBDO Detroit
» THE VERDICT Amusing, but the novelty may soon wear thin

As a spokesman, Zetsch says he finds former Chrys chairman Lee Iacocca a h act to follow. But soon aft arriving at Chrysler in 20(he began to lose his Teuto reserve, starring in the company's theatrical auto show skits. (Last January arrived onstage in a giant **FedEx** packag

The Dr. Z try to convey lot of information, some of whic can get lost i Zetsche's acc In front of th camera, thou Zetsche is a natural. Whe the script for of the TV spo called for hin "head" a soc ball, the dire glumly settle for a day of do-overs. Zets a longtime soccer fan, did one take. Maybe that grac header has made him less believable as a CEO. According to **CNW Marketi Research,** which follows th auto industry, 80% of new buyers think Dr. Z is a fict character. *–David*

SELF-SERVICE

CHECK THOSE IMPULSES

FILE THIS ONE under unintended consequences. Retailers, giddy at the prospect of lower labor costs, are adding self-checkout lanes at a rapid clip. Last year the number of these lanes, which let shoppers scan their own merchandise, grew by more than 35%. But there's a downside: Self-checkout counters are killing impulse buys.

In a survey by **IHL Consulting Group,** which specializes in retail technologies, respondents report what amounts to a 45% drop in impulse purchases at the do-it-yourself counters. It seems customers are so focused on the scanning process at the occasionally glitchy kiosks that they're immune to the lure of Slir Jims and the *US Weekly* w the latest Brangelina cove

Sales of salty snacks an sodas fell most, each drop 50% in the self-scan lines category that fared best, n chocolate candies, still dropped 38.5%. And a no publishers of diet magazi and baby-naming booklet Women's purchases sank in these lanes, compared about 28% for men.

–Jena McG

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The Winning Spirit

HOW COMPETITIVE ARE YOU? What's the inner game of competition all about? What separates the winners from th losers? Consider these questions as you peruse our special double issue, which this year is all about competition. For the occasion we commissioned an exclusive poll on the stat of competition in America. The results underscore just how driven managers in the U.S. really are. For example, 40% of our more than 2,500 respondents said they check their e-mail once a day or more while on vacation. Some 91% admit to going to the office on the weekend. And 22% even said they would fire a good friend to get ahead at work.

In the following pages you will hear directly from great winners, among them Joe Torre, Steve Ballmer, Rupert Murdoch, and Anne Mulcahy. We take a look at business rivalries, such as that of satellite radio networks XM and Sirius. And we go beyond the worlds of sports and business into competition in other spheres—at a camp where budding musical geniuses train, for example, and on a military exercise. We offer you our picks of the world's most fiercely competitive people, organizations, and communities.

Dozens of reporters and editors collaborated on this issue, led by Senior Writer Rose Brady. Special thanks go to the editing team of Peter Coy, Tom Lowry, Harry Maurer, Elizabeth Weiner, and Suzanne Woolley. Steve Taylor, Vera Naughton, and crew designed th issue, and Larry Lippmann and his team managed the photography. The project was overseen by Executive Editor John A. Byrne and Assistant Managing Editors Frank J. Comes, Mary Kuntz, Christopher Power, and Ciro Scotti.

We hope these stories, and additio features on businessweek.com, will surprise, enlighten, and entertain yo

Stephen J. Adler

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ReadersReport

AMERICAN COMPANIES SHOULD BE VERY AFRAID

"EMERGING GIANTS" (Cover Story, July 31) should be read carefully by U.S. companies wishing to survive. Your story moves the discussion away from the often cited "advantages" of the large and inexpensive workforce in emerging economies. Little respect has been given to the innovative talent pools in these countries. That companies in these economies have learned to compete in low-cost environments reminds me of how Toyota learned to compete using innovative production techniques and how U.S. rivals ignored them and instead credited Toyota's success to low costs. Hungry new companies with global connections to management, production, and technical knowhow make the challenge very scary indeed.

–David Braunstein
President and CEO, CMTC
Gardena, Calif.

> "Companies in [emerging economies] have learned to compete in low-cost environments...mak[ing] the challenge very scary."
>
> *–David Braunstein*
> *Gardena, Calif.*

A TELCO SHAREHOLDER BEGS TO DIFFER

MARK GIMEIN'S "The phone companies still don't get it" (Essay, July 31), like most articles written by techies, completely ignores the financial and accounting principles underlying the structure of our information-system complex. Everyone calls for open access between what are really competitors. The telcos are willing to let others have access to their network facilities, provided those competitors pay a fair price based on fully allocated costs—not incremental costs or for free. After all, shareholders paid the billions to create the infrastructure and are entitled to be rewarded. I'm one of them.

–Theodore Luckey Simis
Englewood, Fla.

Editor's note: The writer is a former telecommunications executive.

SEVERAL YEARS AGO I owned a Ford Taurus that disintegrated around me. I've never considered buying a Ford since. Today I find myself using Verizon's mobile service—with access to the phone's multimedia features blocked. Verizon's idea of service is to disable features and charge per usage. I'll forgo the features, and when my contract expires, I'll forgo Verizon.

–Don Reid
Round Rock, Tex.

DON'T DISPARAGE CALL CENTERS

RE "CALL CENTER? That's so 2004" (Global Business, Aug. 7): As one of India's two leading business process outsourcing (BPO) companies, WNS Global Services knows firsthand about corporate managers' growing interest in finding outsourced solutions that provide them with greater efficiency, superior service delivery, and cost savings. Voice-related work is an important part of our service offering. Like our other services, it requires industry knowledge, high-quality execution, and immense discipline to deliver quality day after day. Our call center work is good business—not commoditized business—and about 30% of our revenues are derived from this service.

Ramesh N. Shah
Chairman, WNS (Holdings) Ltd.
New York

WAL-MART'S FEEBLE FASHION FIX

HOW SERIOUS CAN Wal-Mart Stores be when the key to their "biggest sales problem" is taking a grocery aisle manager and making him a fashion merchant ("Fashion emergency at Wal-Mart," Marketing, July 31)? If Wal-Mart were serious, it would hire talented fashion school-trained merchandisers and designers or, failing that, jump on the *Project Runway* bandwagon.

–Martin D. Novar
New York

SINCE WHEN IS INVESTING FOR THE LONG TERM A BAD THING?

SAYING "IF THE ECONOMY turns down, railroads will suffer—and that investment will have been wasted" in your story about Burlington Northern Santa Fe ("Serving two [station] masters," The Corporation, July 24) strikes me as both shortsighted and more appropriate to the age of the once-stifling economic regulations that U.S. railroads have largely been able to shed. Isn't investment inherently long-term? Rail infrastructure typically lasts many years, so why should there be an expectation that investment will be repaid immediately? Kudos to BNSF management for being forward-thinking and willing to invest in the future, cyclical downturns notwithstanding. If population and gross domestic product grow continue, as widely forecast, along wi increases in containerized foreign trad BNSF managers will be seen as visiona ies who enabled their present level profitability to increase in the future.

–George Haml
Fairfax, V

CORRECTIONS & CLARIFICATIONS

The offices of Digg.com, featured in "Valley boys" (Cover Story, Aug. 14), are located above those of the *San Francisco Bay Guardian*, not *SF Weekly*. Also, Digg's CEO, Jay Adelson (not named in full in the story) was former chief technology officer for data center company Equinix, not Equinex.

Because of a layout change in "The Great Corn Rush of 2006" (Special Report, Aug. 14), a photo caption referring to the logen fermenter should not have run.

"Call center? That's so 2004" (Global Business, Aug. 7) incorrectly stated that ICICI OneSource bought a call center in Ireland. In fact, the company has established new business process outsourcing facilities in Northern Ireland.

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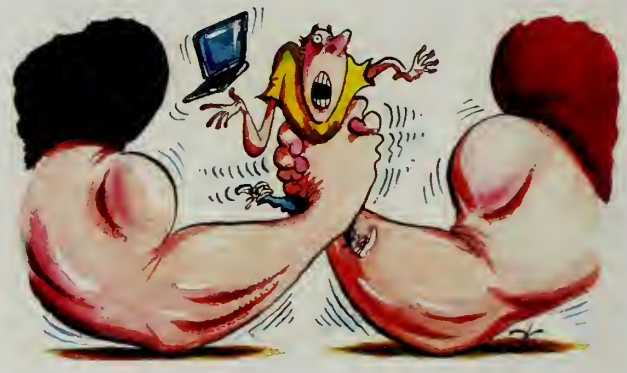
Tech&You

BY STEPHEN H. WILDSTROM

In Praise of a Closed Market

It's an article of faith in the tech industry that competition is a good thin for everyone. Without the freedom to create companies with novel products in competitive markets, we might never have seen some of the innovations that have transformed our lives—PCs, e-mail, iPods, and the rest. Still, for consumers, there definitely can be too much of a good thing

The history of the PC provides a good illustration of where competition works for consumers and where it doesn't. Saying this won't win me friends in competition-crazed Silicon Valley, but I think dominance by an Intel hardware design and Microsoft software has been good for both business and home users.



Standardization, which limits competition on features and turns it into a fight for the lowest price, led to rapid economies of scale and plunging costs. Buyers of PCs didn't have to deal with baffling choices about "platforms," which unrestrained competition usually spawns. So consumers could buy complex products with more confidence than they would have had in a wide-open market.

Of course, there is a downside. Had Microsoft been subject to real competitive pressure—something stronger than the single-digit market share that Apple Computer has been able to muster for the past decade or so—it might have been forced to make Windows better, faster. There is no doubt that after crushing Netscape in the late 1990s, Microsoft let its Web browser, Internet Explorer, languish until the growing popularity of Mozilla's Firefox forced it to make long-overdue improvements. But other than that, I don't think anyone would be better off if businesses and consumers had to choose from among several competing software systems.

THE COMPETITIVE INSTINCTS of consumer-electronics companies have led to a different result in high-definition televisions. Manufacturers refused to go for simplicity and standardization, and this has slowed the transition to HDTV. Faced with confusing options, incompatibilities, and poor information, consumers fear they'll make an expensive mistake, so they hold back. This market will not realize its potential until the industry makes the choices less risky.

There is one jarring irony in this argument. The standardization that allowed computers to show up in practically every home has unleashed a variety of price competition that doesn't ben consumers in every sense. Tr the use of commodity components and standard designs has taken the cost of PCs ridiculously low; you car buy a usable desktop for $30 and a laptop for $500, and n one ever complains about having to pay too little. But t race to the bottom has had t baleful effects. One is that wl there are dozens of products, choice is mostly an illusion. Once you decide on specifications, the offerings within any class are essentiall identical. The pressure to squeeze out every penny of c yields PCs as commoditized a wheat or cement.

Microsoft and Intel simplified choices—and popularized computers

Second, cost pressures hav but wiped out after-sale customer service. It's no accid that Apple, isolated in its mar niche, enjoys both the best reputation for customer servi and the fattest margins on computers. Dell, by contrast, fel into a vicious cycle of cost-cutting that led to cutbacks on warranties and service.

I am not arguing that hot-blooded competition is bad. C the contrary, it beats any alternative. Telephone and cable have proved that with limited competition, you get high prices and terrible service. But it's important to remember that, despite glowing testimonials from technologists and economists, competition is likely to hurt as well as help.

E-mail: techandyou@businessweek.

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MediaCentric

BY JON FINE

Growing by Leaps and Google

Evidence that it's Google's World, part 4,352: Three major deals with the search giant hit the papers in about as many days. They even arrived with lovely sense of orchestration and crescendo: soft to loudest, big to bigges First a deal to pay Associated Press for some of its news stories. Then, on Aug. 7, came a plan to distribute Viacom video clips to hundreds of Web sit

and sell ads within them. And then, an announcement that it would be the exclusive search engine for News Corp.'s MySpace.com and its sibling sites in Fox Interactive Media. Google guarantees $900 million in revenue from search ads to Rupert Murdoch as long as the sites achieve certain traffic goals.

Some thoughts:

1. The most impressive move, in terms of dollars, is the MySpace deal. But this is actually the most conventional of the three, albeit breathtaking in scale (Fox Interactive Media President Ross Levinsohn says that MySpace users—there are more than 45 million of them—will see a Google search box on every MySpace page). Conventional because plenty of newspaper Web sites have search boxes "powered by Google," and each of these in turn comes with its own revenue-sharing pacts.

2. Look for the biggest shadows to be cast by the Viacom deal. It points to an entirely new way to syndicate ad-supported video across the Web. It also gives Google's geeks a new laboratory for testing something that sounds a lot like Google TV: a future in which shows are streamed for free on Google Video, supported by ads, just as streamed shows on abc.com are. "We have already experimented there," points out David Eun, Google's vice-president of content partnerships. Now they can experiment more.

3. One of the key media stories of the year centers on publishers' mounting fear and loathing of Google's tightening grip on the Web. These fears always had more than a tinge of the paranoia once reserved for Microsoft circa 1995: "They already dominate their business. What if they get into mine?" Well, now it looks like they won't. "They can't afford to commit journalism," says a chest-beating Tom Curley, CEO of Associated Press. Which is why they're paying others to do so. So everyone is now easy with them? Um, no. "We continue to have a schizophrenic relationship with Google," offers one newspaper executive who is happy with his Google deals, even though "there is no question that over time, it probably cannibalizes some of our core business," such as classified or retail advertising.

4. Can we talk for a moment about h ridiculous it is that Google's power kee growing? Search is free, so it costs noth to switch from Google. Its three major competitors—Yahoo!, Microsoft, and Ask.com—are spending like crazy to stu its customers. Yet Google not only keep building its market share in search, it's also getting better at leveraging its strength with search ads to swing deals other guys can't. The Google/MySpace hookup is an especially bitter pill for Microsoft, which has tried mightily to strike such alliances. And to layer on th loss, Microsoft counts foxsports.com—excluded fron the Google deal—as one of its search partners.

The flurry of deals shows it's willing to share the wealth

FORBES INC.'S SALE of an undisclosed minority stake to Elevation Partners ends a long odyssey for the Forbes family: gets them exactly what they h wanted for years: a minority investor, a nine-figure sum, an the retention of family control. Earlier this decade, the Forbeses sought around $250 million for about a quarter o the company, says one executive familiar with that attempt which came up short. (Forbes would not comment.) Elevat paints the deal as one aimed at expanding the business, including the fast-growing Web site. An executive elsewhe who is familiar with the financials says total company profi this year are projected to be around $50 million. This executive also confirms that the deal was motivated in large part by the need for family liquidity. In the first half of 200 Forbes had 1,549 ad pages—about 40% fewer than in the fi half of the halcyon year of 2000. To borrow from an Oscar winner, it's hard out here for a business magazine.

BusinessWeek online For Jon Fine's blog on media and advertising go to www.businessweek.com/innovate/FineOnMedia

JAMES C. COOPER

The Fed May Not Have Long To Catch Its Breath

The trend in labor costs suggests it might need to resume hiking rates

U.S. ECONOMY After 17 rate hikes in 17 meetings dating back to June, 2004, the Federal Reserve finally gave investors what they had been pining for: a pause. But no sooner did the Fed's Aug. 8 policy statement hit the newswires than another concern cropped up: Is the Fed really finished? Or will it have to resume raising interest rates

ainst a persistent inflation threat?

Nearly, if Richmond Fed President Jeffrey M. Lacker had his way, the target rate would have been lifted by another quarter-point. Instead, the other nine policymakers voted to take a breather, leaving the rate at 5%. Lacker's dissent suggests there may be growing concern about inflation among other policymakers. The 10-1 vote gave the decision to pause a hawkish tone, and it suggests a risk of more policy tightening.

The Fed's majority statement contained the usual boilerplate covering the relevant inflation worries stemming from tight labor markets, rising pressure on production capacity, and higher energy prices. However, the policymakers expressed confidence the economy was moderating and said "inflation pressures seem likely to moderate over time." That's a big gamble the Fed seems willing to take, at least for now.

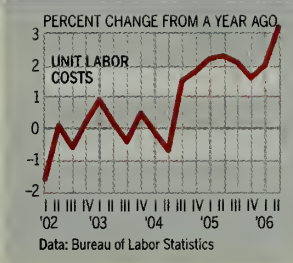
The headline numbers in July's employment report fit the Fed's outlook. They were soothing to investors and undoubtedly provided policymakers with credible justification for a pause in rate hikes that Wall Street could accept without worrying the Fed was going soft on inflation. Payrolls, up 113,000 from June, increased modestly for the fourth month in a row, and the jobless rate rose from 4.6% to 4.8%. The numbers suggested the economic slowdown was on schedule, and that inflation would ultimately subside.

However, another report was much more worrisome. The Labor Dept.'s revised numbers on productivity and labor costs show trends are much less favorable for containing core inflation, which tracks prices outside of energy and food, under control. The report, which came out on the morning of the Fed's meeting, offers new evidence that the pressures on businesses to lift prices are coming from labor costs, not just from high-priced energy and other commodities.

LABOR'S NEW DATA on productivity and costs may turn out to be more important to future Fed decisions than this tame-looking jobs data. Central bankers had noted in their three previous statements how "ongoing productivity gains have held down the rise in unit labor costs." Those trends had helped the Fed to tolerate the recent uptick in core inflation because they suggested the rise would prove temporary. Now, the support for such thinking looks shaky. In fact, the Fed completely omitted the long-standing phrase from its Aug. 8 statement.

The new cost trends suggest this year's rise in core inflation might have deeper roots. Productivity, measured as output per hour worked, rose a slim 1.1% from the first quarter. More important, revised data now show productivity over the past two years has grown only 2% annually, the slowest two-year pace in eight years. Earlier numbers through the first quarter had shown two-year efficiency gains averaging 2.7% per year. In other words, productivity growth, while still pretty good, is not offsetting rising labor costs as much as had been believed.

A TREND THAT COULD PUT THE FED IN A BIND



Data: Bureau of Labor Statistics

What is especially disconcerting for the inflation outlook, though, is the Labor Dept.'s steep upward revision to workers' hourly compensation. Over the past year, hourly wages and benefits have grown 5.7%, more than double the 2.4% pace of productivity. And unit labor cost, or the average cost of making one unit of a product, has accelerated sharply over the year, recently up 3.2%, the biggest surge in 5½ years (chart). Old data through the first quarter showed unit costs barely rising.

These trends are critical to the Fed's thinking about the economy's potential to generate inflation, and they might have played a role in the Fed's split vote. History shows accelerating unit labor costs, if not contained, can fuel a sustained pickup in inflation, which is difficult for the Fed to reverse without substantial economic pain.

DESPITE LAST MONTH'S MODEST increase in payrolls and the rise in the jobless rate, other indicators show labor markets remained quite tight as the second half of the year got under way. Weekly unemployment claims heading into August remain low, which does not suggest

either a steep or lasting slowdown in job growth.

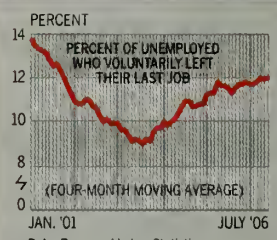
Also, a gauge of job security, the percentage of unemployed people who voluntarily left their last jobs, shows no new concern about market conditions. On the contrary, even as job growth has slowed over the past four months, the share of job leavers averaged 12%, the highest in almost five years (chart).

Indeed, one factor pushing up the jobless rate in July might well reflect the job market's strength. Economists at J. P. Morgan Chase say all of July's 248,000 rise in unemployed people were reentrants into the labor force who had previously stopped looking for work. These workers have been pulled back into the job hunt, perhaps by the lure of faster wage growth. The rise in reentrants was the largest in a decade.

However, there appears to be a growing mismatch between the skills companies need vs. the skills of people seeking work. The July rise in joblessness was concentrated among workers who either had dropped out of high school or had only high school diplomas. This observation meshes with the latest *Management Barometer* from PricewaterhouseCoopers. Senior executives rank a shortage of qualified workers and pressure to increase wages as two of the top three barriers to growth over the next year, along with energy costs.

ONE IMPLICATION for economic growth, however, is that tight labor markets will push wages higher and boost the spending power of consumers. Workers' income from wages and salaries in the second quarter rose 6.8% from a year ago, the fastest such pace since late 2000 and w above the energy-driven 4.3% increase in consumer prices. In July, hourly wages of production workers showed another strong gain, putting them 3.8% ahead a year ago. Factoring in the 2.2% increase in hours worked over the past year, the income of production workers continued to grow about 6% in July.

HARDLY A SIGN OF JOB INSECURITY



Data: Bureau of Labor Statistics

This partly explains why consumer spendi held up pretty well in July. Car buyers responded to a new round of sales incentiv and pushed vehicle sal to a 17.2 million annua rate last month, vs. the second-quarter averag of 16.3 million. The month's report on cha store sales looked upbeat, and consumer confidence remained buoyant.

Despite the weakness in housing, overall demand is not clearly cooling enough to ease inflation pressures. Until it does, businesses will try to pass along higher labor and energy costs into the prices for their final products. The Fed paused in August, believing inflatio will slow, but if demand and labor market pressures prevent that from happening, investors will need to bra for more rate hikes. ■

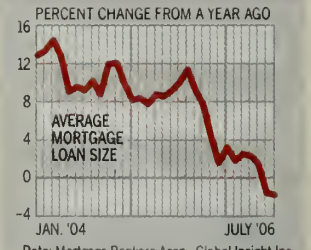
HOME SALES

Why Housing Looks a Little Rickety

HOPES THAT THE WORST of the housing slowdown has already come and gone may be dimming. Mortgage rates stopped marching higher during recent weeks, and home sales, after tumbling this winter, appeared to stabilize this spring. But recent data indicate further weakening is yet to come.

The weekly snapshot of lending activity by the Mortgage Bankers Assn. (MBA) not only includes figures on mortgage applications to buy homes but also on the average size of the loans being sought. Both measures are seen as timely indicators of the housing market and both, after leveling off during the spring, are plunging once again.

SMALLER MORTGAGES SUGGEST LOWER PRICES



Data: Mortgage Bankers Assn., Global Insight Inc.

Based on monthly averages, mortgage applications are now falling at the fastest pace since 1995. In July they were down 15.1%. The Aug. 9 update showed the weakness continued into August.

Moreover, the deterioration in the pool of interested home buyers is forcing sellers to further lower their price expectations. The average mortgage loan size is now smaller than it was a year ago, off by 0.5% from last July. This suggests further weakness in home prices because "average loan size is a reasonable coincident or slightly leading indicator of home price inflation," Goldman Sachs economist Jan Hatzius says in an Aug. 2 research note.

There are other reasons to expect that prices will k softening. The national vacancy rat of homeowner housing hit a record high of 2.2% in the second quarter. The higher vacancy rate was most likely driven by the rising inventor new homes for sale. In June, the le of completed new homes on the market swelled by 28.2% from a ye ago. Rising inventories and weak pricing are significant reasons why homebuilders have become increasingly pessimistic.

Housing may catch a break with the Federal Reserve finally holding interest rates steady at 5.25% on Aug. 8. Mortgage rates should keep hovering around the current 6.6% level. However, economists are not convinced that the Fed is finished tightening. Further rate hikes coul push more potential home buyers away, striking another blow to an already vulnerable market. ■

–By James Mehring in New Y

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The Business Week

News you need to know

EDITED BY HARRY MAURER

Oil Patch Angst Someone must be sticking pins in a voodoo doll representing **BP.** On Aug. 7 the oil giant said it would shut down **Prudhoe Bay,** the Alaskan field that produces 8% of the oil consumed in the U.S., for weeks or months. Inspectors found corrosion and a small leak in an aging pipeline network (checking pipe, above). This follows an explosion at a Texas BP refinery last year that killed 15 workers, a spill in March in Alaska that leaked 250,000 gallons, and accusations by regulators that BP traders manipulated propane prices in 2004—charges the company denies.

The news sent oil skyward by 3%, to $77 a barrel, and couldn't come at a worse time for consumers, with world supplies tight. Under **Chief Executive John Browne,** BP has tried to position itself as the most environmentally cozy oil major by pouring money into solar power and changing its logo to a green and yellow sun.

ONLINE *See "BP's pipeline trouble," www.businessweek.com/go/tbw*

The Fed Chills Out **Ben Bernanke's** Gang of Ten voted on Aug. 8 to take a break from its rate-hiking campaign. But there are signs they could soon go back on the warpath.

See "The Fed may not have long to catch its breath," page 25, ONLINE *and "The pause that perplexes," www.businessweek.com/go/tbw*

Eating Up Aramark How many handsomely paid financiers does it take to bring one company private? For food-service company Aramark the answer is: a bunch. **CEO Joseph Neubauer,** who took the company private once before, may put in as much as $250 million. He and private equity firms will pay $6.3 billion—and assume billion in debt—for the vendor to college cafeterias baseball parks. **S&P** cut Aramark debt to junk status.

Googlewood What's better for Hollywood moguls tha big audience? A big audience with money. Google has b offering eyeballs and bucks to both **News Corp.** and **Viacor** separate deals. Google will pay an estimated $900 millio provide a search engine to News Corp.'s mammoth **MySp** social network site. And it will sell shows from Viaco **MTV** and distribute ad-supported videos of other Viac shows to hundreds of Web sites.

See "Growing by leaps and Googles," page 24, ONLINE *"Google's duet with MTV" and "Google gets b into MySpace," www.businessweek.com/go/*

Options Watch The options scandal continued to dar reputations, including that of normally Teflon-coated **S Jobs.** On Aug. 3, **Apple** said it might have to restate earni from 1997 to 2001 because of options irregularities. Aug. 7, Bloomberg reported that another Jobs company, imator **Pixar,** may have backdated options repeatedly. Aug. 8, New York cable giant **Cablevision** said it would state for six years, and the next day three ex-**Comverse Te nology** officers were indicted in New York on fraud char related to the alleged manipulation of grant dates.

ONLINE *See "A worm in the App www.businessweek.com/go/*

Cisco Celebrates **NASDAQ** to Cisco: Thanks, I nee that. The networking goliath posted better-than-expec results on Aug. 8, lifting some of the tech-heavy bour malaise of recent months. Cisco's quarterly sales rose 2 thanks to brisk overseas demand and signs of an upgr cycle among its bread-and-butter corporate buyers. **John Chambers** said the company could grow as much 20% in the next year. The stock leaped 15% on the ne and other networking shares came along for the ride.

Martha Settles... The fight is over. On Aug. 7, **Mar Stewart** agreed to cough up $195,000 to settle her civil ins er-trading case with the **SEC.** Stewart can't be a director public company for five years or engage in activities like nancial reporting at her company—a twist from the us blanket ban on being a director or officer. She served months in jail for lying about a 2001 sale of **ImClone** stock

...And So Does Toyota Wasting no time, Toyota pu rest a salacious sexual harassment case just three mon after it was filed. **Sayaka Kobayashi,** an assistant to **Hide Otaka,** head of **Toyota Motor North America,** accused her b of making repeated sexual and romantic advances. Toy had previously said Otaka would take a new post back Japan. But in announcing a settlement on Aug. 3, Toy stated that both Otaka, 64, and Kobayashi, 42, had left company. No terms were disclosed.

NFL's New Quarterback More than 30 names bandied about, but in the end, as expected, the **National all League** picked one of its own. **Roger Goodell,** 47, the executive under outgoing **Commissioner Paul Tagliabue,** ed at the league as an intern 24 years ago. The new nish won't have to worry about negotiating TV deals or or pact with players any time soon because Tagliabue hose done. His priorities will be bringing a team back to **Angeles** and trying to make an essentially American t more international.

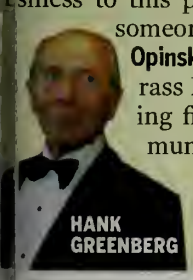
ey Pension Case It was too late to matter much to when on Aug. 7 the U.S. 7th Circuit Court of Appeals l that its former pension plan didn't discriminate nst employees based on their age. But the decision ers a lot to other companies. The ruling and a law re- y passed by Congress confirm the legality of more 1,200 so-called cash-balance pension plans, under h employers promise to contribute a certain percent- of employees' annual salaries but don't guarantee a un payout. In September of 2004, IBM settled part of ase, agreeing to pay the plaintiffs about $300 million. year it eliminated its cash-balance plan and boosted pany contributions to the 401(k) program.

Bono, Meet Mr. Forbes It sure looks like the Odd ple. On Aug. 4 the Forbes family revealed that it had a chunk of a new company, **Forbes Media,** to **Elevation ners,** a group led by private equity ace **Roger McNamee** including activist rock star **Bono** of U2. The family will ably take out some of the estimated $250 million to 0 million and invest much of the rest in **Forbes.com.**

See "Growing by leaps and Googles," page 24, and
ONLINE *"Elevation aims high," www.businessweek.com/go/tbw*

Lawsuit of the Week

Hank Greenberg's private insurance empire struggling? Aug. 7 the former **American International Group** chief ed three AIG staffers—and up to 100 co-conspira- s—alleging that they have tried to "systematically stroy" the four private insurance companies he now ns under **C.V. Starr.** It's yet another missile in the ongo- war between AIG and Greenberg, 81, who was oust- amid accounting scandals last year. But the lawsuit o prompts some to ask how the four highly special- d agencies are doing. During Greenberg's 38 years at G's helm, Starr was closely tied to the insurance giant. **rrill Lynch** says AIG doesn't seem to have lost much siness to this point, so unless the pie has grown, someone is suffering. Spokesman **Howard Opinsky** says AIG is just "continuing to ha- rass Mr. Greenberg," but that Starr is doing fine nevertheless. AIG prefers to stay mum. Nobody wins in a nasty divorce.


HANK GREENBERG

ONLINE *See "Greenberg's lawsuit: sign of trouble?" www.businessweek.com/go/tbw*

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IMMIGRATION

'IF WE CAN TAKE ONE BIG EMPLOYER DOWN...'

The Minuteman Project, the controversial border watchdog, is now targeting companies that hire undocumented workers

BY SUSAN McMILLAN

EMPLOYERS, BRACE YOURselves. From Atlanta to Chicago to Denver, the Minutemen are setting their sights on you. This army of angry citizens plans to police your workplace, and if they find any illegals, they'll report you to the government.

In case you've never heard of it, the Minuteman movement originated two years ago and gained notoriety for sending members armed with binoculars to states that border Mexico. When the volunteers spot people entering the country, they call the U.S. Border Patrol. Critics, including President George W. Bush, characterize them as "vigilantes."

Now dozens of branches are popping up in the heartland (page 32). They're targeting companies as well as workers. "If we can take one big employer down—handcuffs, federal prison terms, their property seized—we will make a great step forward toward having our laws enforced," proclaims Jim Gilchrist, a 56-year-old retired accountant who founded the Minuteman Project in California in 2004 out of anger at illegal immigration. He says his group, which is supported by dues and donations, has seen its national membership jump by 1,000 since April, to 2,500. A like-minded group, the Minuteman Civil Defense Corps, which claims 8,000 members in 49 chapters, also has begun targeting employers who use day laborers.

To get a feel for the motivation and methods of the Minutemen, consider Daniel Switala. The 43-year-old general contractor closed his small contracting business near Atlanta early this year because of what he saw as unfair competition from rivals who hire undocumented workers. On a muggy August morning, he jumps into his aging gray SUV and heads to a day-labor hiring site. It's under a shady tree in the parking lot of a thrift store in suburban Roswell, Ga. When Switala pulls in, several of the few dozen men waiting there come over and ask: "How many do you need?"

UNDERCOVER TACTICS

BUT SWITALA ISN'T looking for cheap labor. Instead, he has a question for the men, all of whom appear to be Latino. "Are y'all legal?" he asks. Some walk away. Others warily respond, mostly saying no. A few say yes, and one, Miguel Escobedo, even produces a green card. It expired last December, and he explains to Switala that he has applied for a new one. Escobedo later tells a *BusinessWeek* reporter that he came to the U.S. from M ico in 1987. Earlier that day, Swi stopped at a local electrical comp where he posed as a job applicant. But real aim was to grill managers about staff's legal status.

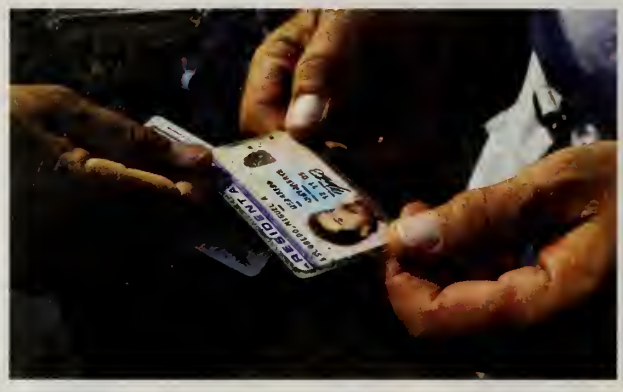
The in-your-face tactics of Switala other Minutemen could help drag c panies directly into the fray over im gration. Although civil rights groups cry their methods as harassment, Swi says he and other volunteers in Atlan mostly workers in landscaping, paint and construction who feel threatene illegal labor—aren't going after im grants. Rather, they snap pictures of d ers who pick up day laborers, call to them they may be hiring illegals, and port them to the local office of the Im gration & Customs Enforcement (I They also ask employees for tips on workers who might be illegal at Atla area employers, from local contrac and restaurants to Home Depot Inc. Wal-Mart Stores Inc.

At the same time, the Bush Admi tration is attempting to placate the Right by stepping up enforcem against employers. In April, Homel Security Dept. Secretary Michael Che announced an ICE campaign to focu those who knowingly hire illegals. In

past most violators got off with a fine. But as of July, ICE has made 445 criminal arrests of employers and labor contractors, vs. 176 last year, according to ICE.

The new effort gives the Minutemen an opportunity to funnel complaints to officials. The Atlanta chapter, opened only in April, already has reported 200 employers to ICE, says Donna Walker, chapter president. (Walker decided to join the Minutemen after her son-in-law closed his painting business due, she says, to cheap illegal labor.) "Regardless of where [it] comes from, we look forward to information coming from the public," says Ken Smith, a special agent in ICE's Atlanta office. He says he has received complaints from the Atlanta Minutemen, although no prosecutions have resulted so far.

Atlanta is only one of many active Minuteman chapters. In Herndon, Va., Minuteman Corps chapter head George Taplin, a 52-year-old software engineer who got involved when his city approved a day-labor site, says local contractors now pick up day laborers in unmarked vehicles after his group began photographing them. In Chicago, a Minuteman group has mounted protests against Dutch Farms Inc., a meat processor, after employees claimed that 15 workers had been replaced with illegals. (Dutch Farms didn't respond to calls for comment.)



PROVE IT If workers aren't legal, employers may be arrested

This explosion of activity presents a potential hazard for U.S. employers. The immigration debate in Washington is deadlocked between hard-line House Republicans who want a border crackdown and a Bush-backed guest worker/legalization bill that passed the Senate in May. To take their case to the public, GOP Representatives running for reelection in the fall are holding hearings around the country to highlight illegal immigration. That could play into the hands of the new activists. Meanwhile an outpouring of sentiment against illegals has resulted in the passage of 13 employment-related immigration state laws this year. And numerous cities are considering variations on the "illegal immigration relief" ordinance recently adopted by tiny Hazleton, Pa., which levies fines against businesses that hire illegal workers.

"RACIST VIGILANTES"

THE TACTICS USED BY Switala and others are hugely controversial. Critics say they raise the specter of discrimination and civil rights violations. After all, you can't tell by looking whether a day laborer or anyone else is authorized to work in the U.S., points out Sara Gonzalez, president of the Georgia Hispanic Chamber of Commerce. "If I'm standing at a corner with a group of friends, I don't have a sign on my chest that says I'm undocumented," she says. Says Enrique Morones, founder of San Diego immigrant rights group Border Angels: "These are a bunch of racist vigilantes that represent the worst of the American spirit."

Switala doesn't see it that way. He says many of the 80 to 100 Atlanta Minutemen consider themselves patriots defending the law. So they target day-labor sites and employers such as Home Depot and Wal-Mart. Home Depot denied receiving calls from them. Wal-Mart says it reached out to the group after seeing press reports. "We were afraid they were profiling people," says Wal-Mart spokesman John Simley. After avoiding charges last year related to illegal contract workers cleaning its stores, Wal-Mart created an immigration hotline. Simley says it also encouraged the Atlanta group to call company immigration counsel Maggie Esquivel. This kind of increased scrutiny from the public, he says, should serve as a "call to action" for businesses. "You have a phenomenon where everyone is taking [illegal immigration] more seriously."

Such talk is what Switala and other activists want to hear. Marietta (Ga.) resident D.A. King, who quit a job selling insurance in 2003 to battle illegal immigration, isn't a Minuteman but also goes after employers. He's sure many are worried: "We may not be the federal government, but we are watching them, and we are making reports."

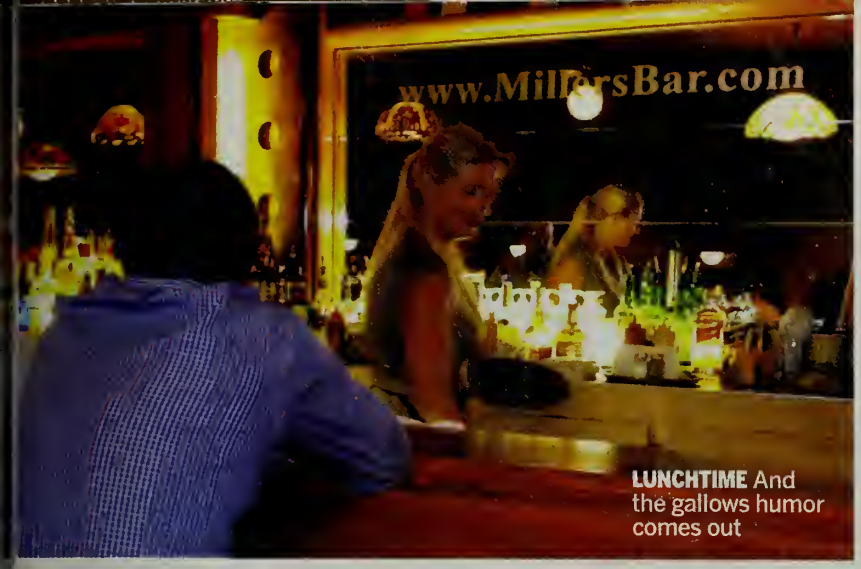
–With Roger O. Crockett in Chicago and Christopher Palmeri in Los Ange

Heading to the Heartland

The Minuteman Project is opening chapters in nonborder states. Its target: employers who hire illegals

NOTE: DOES NOT INCLUDE BRANCHES OF THE MINUTEMAN CIVIL DEFENSE CORPS

Data: The Minuteman Project



LUNCHTIME And the gallows humor comes out

AUTOS

TRICKLE-DOWN DESPAIR AT FORD

A series of strategy zigzags has left the rank and file edgy about the future

BY DAVID KILEY AND DAVID WELCH

PULL UP A STOOL DURING lunch hour at Miller's Bar, a modest but popular joint a mile west of Ford Motor Co.'s boxy "Glass House" headquarters in Dearborn, Mich., and you can hear plenty of frazzled workers worried about the state of the company. A plainly decorated haunt with a dimly lit bar, it's a Dearborn institution where burgers, fries, and onion rings are the only fare and everything is served on wax paper. Forget silverware. "I like the atmosphere in here better than I like work these days," says one 20-year veteran now in fleet sales and service.

These are hard days in "Ford Country," as Dearborn is often called. Market share has fallen four points, to 16%, since 2001, when family scion William C. Ford Jr. took over. The company is worth $17 billion, half what it was then. Things have gotten so bad that Ford has hired an investment banker to look into selling off troubled luxury brands like Jaguar.

These problems are well-known. What outsiders can't detect is the depth of employee despair, much of which stems from internal problems such as management churn and constant strategy changes. At Miller's, another senior manager who last April was bused to a conference center on the grounds of the Henry Ford historical museum in nearby Greenfield Village for a presentation about the company's dire health, said he has never felt so downbeat. "The trouble with the auto business is that it takes years to fix what's wrong," says this employee, who, like others, did not wish to be identified for fear of losing his job. "We're four years into fixing it already, and it will be three more years till we see any daylight. Who ever heard of a seven-year turnaround plan?"

Nobody. The prevailing feeling around Dearborn is that CEO Bill Ford would have been fired by now by most boards if his name were Smith. Indeed, there are betting pools on how long Ford will remain CEO, says another Glass House denizen. Seldom looking at ease in the role, Bill Ford admits he struck out trying to recruit DaimlerChrysler Chairman Dieter Zetsche and Renault-Nissan CEO Carlos Ghosn for the job. He's still searching for a replacement. "Bill is pretty serious about finding a CEO," says a source close to him, adding that "the Ford family would be happy to have a new CEO."

> "The trouble with this business is that it takes years to fix what's wrong.... It will be three more years till we see any daylight."
>
> *–A Ford manager in Miller's Bar, Dearborn, Mich.*

REVOLVING DOOR

MARK FIELDS, HEAD OF Ford's North American auto operations, says he knows it's a tough slog. "Is it tense? Yes." Despite Fields's efforts to inspire the troops, his appointment epitomizes much of what's wrong with the company. He's the fourth head of North American operations in four years. Ford has also had three product development chiefs and four heads of Ford Europe in that time. "The churn of executives has cost Ford valuable time in making headway in the turnaround," says Earl Hesterberg, CEO of mega-dealer Group1 Automotive, who left a top marketing job at Ford last year.

That churn has left Ford with models less exciting than those of Toyota, Chrysler, and General Motors, just when the original restructuring plan should be yielding fruit. Employees say gallows humor is becoming commonplace. One engineer who has worked for Ford for more than 20 years says it's common to find negative news stories circulated by e-mail, like a recent one headlined "Run, Forrest, Run" (referring to Forrest Gump), as a warning to quit or take a buyout offer before a mass layoff. If you wait for a buyout, the logic goes, you might end up among a bigger wave of workers, trying to sell a house in the already glutted real estate market of Michigan, a state with more than 6.3% unemployment.

At Miller's, two guys sit at the bar eating burgers and talking about the surprising success of the Detroit Tigers. At least that's something to cheer about. The Ford family owns the Detroit Lions, which have had three head coaches in the past five losing seasons. August preseason camp is under way at the same time Ford is wrangling new restructuring plans it will make public next month. For the Lions, there's always next year. Ford Motor doesn't have that luxury.

BusinessWeek online For an interview with Ford's North American auto operations head Mark Fields, go to businessweek.com/extras

POCKETBOOK POLITICS

THAT SINKING FEELING

Voters were bummed when the economic stats were good. Now what?

IMPERILED Wilson with Bush at a fundraiser in Albuquerque

BY RICHARD S. DUNHAM

FOR MONTHS, PRESIDENT George W. Bush has recited a litany of statistics that, he says, reflect a robust economy: rising gross domestic product, low unemployment rates, higher wages, record homeownership, declining deficits. The bad news for Bush is that the public doesn't buy his numbers. Instead, voters have become increasingly disgruntled about a different set of factors describing rising energy and health-care costs and wages that don't keep pace with inflation.

Now, the politics of the economy could go from bad to worse for Bush and his fellow Republicans. The most recent round of government economic numbers indicates slower growth, falling productivity, skittering home sales, and rising joblessness, all factors that could loosen the GOP's 12-year grip on Congress. Among the Republican lawmakers imperiled by resurgent pessimism: Representatives Heather A. Wilson (N.M.), Nancy L. Johnson (Conn.), Curt Weldon (Pa.), and Deborah Pryce (Ohio).

Although most economists remain bullish on the overall economy, all but the wealthiest voters are distinctly bearish. A July 18-21 survey by the nonpartisan American Research Group found that just 6% of Americans believe the economy will improve in the next year, while 67% are convinced it will get worse. "There is a very big disconnect between the way the public thinks about things and how economists think about things," concludes Andrew Kohut, director of the nonpartisan Pew Research Center.

The result is a mixture of befuddlement and anxiety in Republican circles as strategists try to figure out how to convince Americans that things are really better than they believe. "The experts tell us the economy is humming along," says Representative Thomas M. Reynolds (R-N.Y.), chairman of the National Republican Congressional Committee. "It's just not burning in. I can't explain it."

THE FRIEND FACTOR

POLLSTERS WHO STUDY the nexus of pocketbooks and politics say the old big-picture factors that used to predict how the economy would influence elections—unemployment, inflation, and GDP growth—are out of date. "We need a new set of economic indicators," says independent pollster John Zogby.

Analysts say the new basket of stats should include those that directly affect a family's bottom line, such as inflation-adjusted wages, energy prices, and out-of-pocket health-care costs. But the most important economic predictor of political behavior, pollsters say, is a voter's subjective view of the future. Zogby thinks the key to a dimmer outlook is whether individual has a friend relative who recently lo job or was forced i lower-paying work.

Pollster Thomas Riehle of RT Strateg concludes that the gap tween perceptions of national economy to and expectations for coming year show t voters "are saying we'r risky times, and that's v negative for incumbent

American Enterpr Institute economist Ke A. Hassett, a former ad sor to the campaigns President Bush and Se tor John McCain (R-Ari says that the war in Iraq has clou traditional economic models used to p dict voter behavior. "There is an unu ally high correlation between how we doing in the Middle East and [perc tions of] the economy," he says. "Peo keep on spending, but they say th don't feel good about the economy."

Is there any good news for Repub cans? In the second quarter of 2006, ci ian wages and salaries rose at a 3.6% nual rate, the fastest pace since 20 Republicans believe that if wage grov continues to accelerate, and inflat cools, Americans may feel a bit m cheerful as they see their real earnings crease for the first time in years.

But Democratic strategists say any w growth is more than of by soaring costs of fo fuel, medical costs, lo taxes, and tuition. "T more they talk about economy and Iraq, more it hurts them," s Democratic pollster St ley B. Greenberg.

Republican strategi hope to reframe the bate by depicting I mocrats as advocates job-killing tax hikes. the same time, they prepared to focus m attention on immig tion, flag burning, a same-sex marriag social issues that tend rally the GOP faithful.

Anxious Times for Americans

Voters are growing increasingly uneasy about the economy

THE NATIONAL ECONOMY A YEAR FROM TODAY WILL BE:

BETTER:	6%
THE SAME:	25%
WORSE:	67%

Data: American Research Group Inc

DDLE EAST

EEING PAST HE WAR

calating violence isn't aring investors away

STANLEY REED

DESPITE ESCALATING VIOlence in Lebanon and Israel, money is continuing to flow into the Middle East as investors focus on potential growth rather than strife. After an initial dder when the war broke out, stock rkets have bounced k, with the benchmark mes Financial Index in ro, a key regional exnge, up by 17% since e 30. The draw? Fastwing economies, tens of ons of dollars in oil ney, and initial public rings on the horizon. ter this madness, there be an enormous unt of infrastructure ending] as well as prization," says Arif M. qvi, CEO of Dubai pri-e-equity firm Abraaj ital.

Naqvi himself is making of the biggest bets. In July, Abraaj offered 0 million for a 25% ke in EFG-Hermes, a ro investment bank. raaj, owned by Gulf intors and Deutsche k, says EFG has the ch and savvy to become ominant regional play-Another plus: In Janu-, EFG itself bought 25% Lebanon's Bank Audi \$500 million.

New York private-equity p Ripplewood Holds is also getting into the In February, the comy led a group that laid some \$230 million for ut 20% of Cairo's Commercial International Bank, and now it aims to expand further. CIB is "a perfect foundation for a much broader financial services business in the region," Ripplewood CEO Timothy C. Collins said on Aug. 4. He and former Citigroup Chief Operating Officer Robert Willumstad are joining CIB's board, and former U.S. Federal Reserve Chairman Paul A. Volcker will act as an adviser.

A SENSE OF OPPORTUNITY

OF COURSE, THERE ARE plenty of risks. While the wars in Lebanon and Iraq look containable, they might spread. The standoff with Iran could blow up; oil flows could be disrupted. Moreover, some Arab exchanges look pretty dismal after skyrocketing in 2005. The Dubai Financial Market is down 61% this year, and the Saudi Tadawul Index has dropped by 35%. Cairo has held up far better, though it, too, is off—by 9% for the year.

Still, plenty of investors sense an opportunity. The market for investment banking services in the Arab world, including asset management and stock trading, is growing at nearly 40% per year from its current level of more than \$5 billion, says Hassan Heikal, EFG's co-CEO. And Saudi Prince Alwaleed Bin Talal's Kingdom Holdings, Dubai-based media company Showtime Arabia, and Dubai Ports World (the outfit that stirred up controversy when it got a contract to run U.S. ports), are all contemplating IPOs. "This is a great business opportunity," says Georges Makhoul, Morgan Stanley's new Dubai-based president for the Middle East and North Africa. Makhoul expects to have 28 professionals in place by fall, while both Citigroup and Merrill Lynch are members of the new Dubai International Financial Exchange. Says Makhoul: "It feels just like when we went into China in 1994."

–With Nichola Saminather in New York

CAIRO Shares fell as war broke out, then rebounded

THE STAT

17%

Increase in Cairo's benchmark Hermes Financial Index since June 30

Data: Bloomberg Financial Markets

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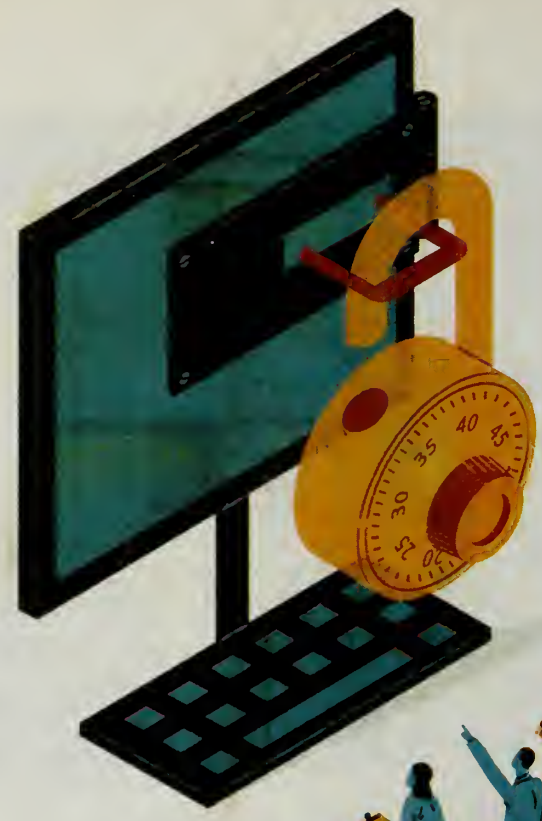
SOFTWARE

HEADING OFF THE HACKERS

Microsoft pulls out the stops to boost security



BY STEVE HAMM

FILE IT UNDER THE CATEGORY of "be careful what you wish for." In early August at the Black Hat Conference, an annual meeting of computer security experts in Las Vegas, Microsoft Corp. handed out 3,000 test copies of its new operating system, Windows Vista, and challenged attendees to help spot security glitches. A short time later, Joanna Rutkowska obliged. In a packed ballroom at Caesar's Palace, the 25-year-old Polish programming whiz delivered a devastating presentation in how to hack an earlier but similar test version of Vista. Before a crowd of fellow researchers and hackers, she bypassed security measures and implanted a potentially undetectable piece of malicious code called "Blue Pill." The presentation, titled "Subverting Vista Kernel for Fun and Profit," was rewarded with a hearty round of applause.

The exercise wasn't much fun for Microsoft security mavens. They put on a brave face: "We'll take a look and see if there are ways we can mitigate it," says Stephen Toulouse, program manager for Microsoft's 650-member Security Response Center. But Rutkowska's demo was the latest reminder of how difficult it will be for Microsoft to make the new version of its flagship product truly secure.

Microsoft went to full battle stations over PC security four and a half years ago, when Chairman William H. Gates III acknowledged in a memo to his staff that the plague of viruses and worms afflicting Windows and other products had gotten out of hand and something drastic had to be done. Henceforth, Gates decreed, security would be the top priority. All programming was temporarily halted as Microsoft embarked on an effort to make its products safe.

Soon we'll know if the delay was worth it. The business version of Windows Vista will arrive late this year, with a consumer version due in early 2007. Vista is Microsoft's first new PC operating system in five years and the first version of its flagship product to get a full security makeover. Hackers are expected to probe Vista relentlessly for vulnerabilities after final versions come out. But already there are signs that Microsoft may fall short of Gates's goal—at a time when it's facing pressure from a resurgent Apple Computer Inc., which suffers few security problems.

Windows Vista's release was delayed to beef up its defenses

For Rutkowska, the Black Hat Conference was just another day at the office. She works for Singapore-based COSEINC, specializing in technologies used by hackers to cloak their activities. Her job is to anticipate the moves of criminals. "I see this as a continuous process, an endless game of chess, where nobody can really ultimately win. It's essential, then, to enjoy the game itself," says Rutkowska. She says she has always been a "white hat" programmer and never created malicious code like "black hat" hackers do.

Toulouse points out that revelations such as Rutkowska's are exact why Microsoft engages in a ru ning conversation with securi folks: "We realize we don't kno everything. These people ho the keys to making our produc more secure."

SPOTTING FLAWS

INDEED, INDEPENDENT sec rity researchers are fast becor ing the tech industry's first li of defense against viruses a other hacks. They typically g paid for staging test attac on company computing sy tems and gain bragging rights spotting flaws and showing h to exploit them. "You'd rath have the vacci from researche than a malicious a tacker giving you t real disease," sa Phil Zimmermann, security pioneer.

Microsoft had r ceived only a sma tering of feedba from other Bla Hat attendees as press time. But r views are trickling in from establish security companies, with mixed a praisals. Symantec Corp. recently issu two white papers analyzing Vista strengths and weaknesses. "Overall, i very solid," says Vincent Weafer, seni director at Symantec Security Respons Still, he warns that the need to ma Vista compatible with applications wr ten for earlier versions of Windo "creates some holes." Bruce Schnei chief technology officer for consultan Counterpane Internet Security Inc., less charitable: "It's more complex th the last one, and complexity is the wo enemy of security. If you want securi buy a boat, not a cruise ship."

Even Microsoft admits that Vis won't be perfectly safe. "You can't get t code 100% right," says Toulouse. I points out, however, that Windows Se er 2003 was more secure than Windo Server 2000, thanks to an extra year security work tacked onto the end of t development process. Toulouse believ Vista will do even better.

We'll see. A few days after the Bla Hat Conference wrapped up, Rutkows was back at her desk in Warsaw comi up with new ways to bedevil Microso And you can bet that others will work ju as hard, with less noble intentions. ■

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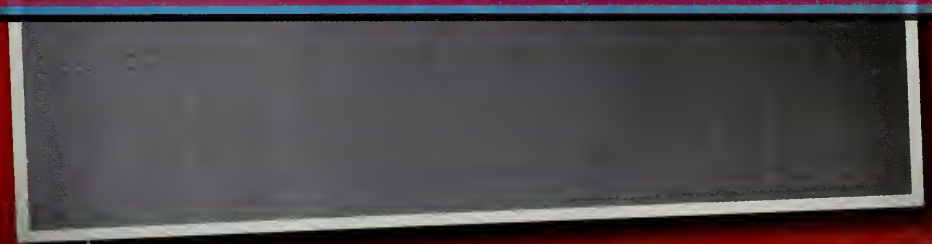

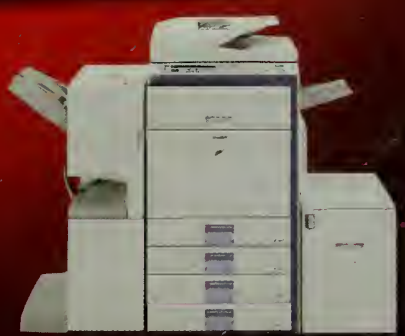

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SWEET LIFE Karter and employees

Scones and Social Responsibility

Dancing Deer Baking's Karter has a recipe for creating a brand with values

BY STACY PERMAN

PATRICIA KARTER, CEO OF Dancing Deer Baking, is used to hearing people rave about her company's all-natural sweets, such as its Cherry Almond Ginger Chew cookies. She also often hears praise for the $8 million company's philanthropy, green packaging, and commitment to its 65 employees and inner-city Boston. All of which makes Karter a bit chagrined. Great-tasting baked goods aside, she thinks every company could be doing what she's doing.

"We've created a brand with important values," says the 49-year-old Karter. "But Dancing Deer is not big enough to make an impact, to be a social or economic force. If I hit $50 million in sales, it can be."Karter is determined to expand the company she co-founded in 1994 and to hang on to her principles while doing so. She's already turned Dancing Deer from a startup selling homemade scones into a profitable wholesale, mail-order, and online business. Its cookies, brownies, cakes, and mixes, all packaged in recycled fiber and whimsically illustrated with stick-figure bakers and dancing deer, are found in Whole Foods Market, Williams-Sonoma, and Wild Oats Markets.

Karter still eschews artificial ingredients, and all employees receive stock options as well as free lunches. Some 35% of proceeds from the Sweet Home line cakes go to help homeless people fi housing and jobs through a coalition Boston nonprofits. And even though t company will soon need more than twi the space of its current 18,000 squa foot quarters, Dancing Deer will stay low-income Roxbury rather than reloc to the less expensive suburbs.

Sticking to her guns hasn't been easy. the late 1990s, Karter nixed a deal to s molasses clove cookies to Williams-Son ma—which would have doubled sales—l cause it would have required her to u preservatives. Her steadfastness impress the bigger company, which later asked h to make mixes it could sell in its stor "They are a wonderful company," says S ly Geller, divisional manager of Willian Sonoma's retail food division. "I have gr respect and admiration for Trish and wh she has done in providing high-qual products with natural ingredients."

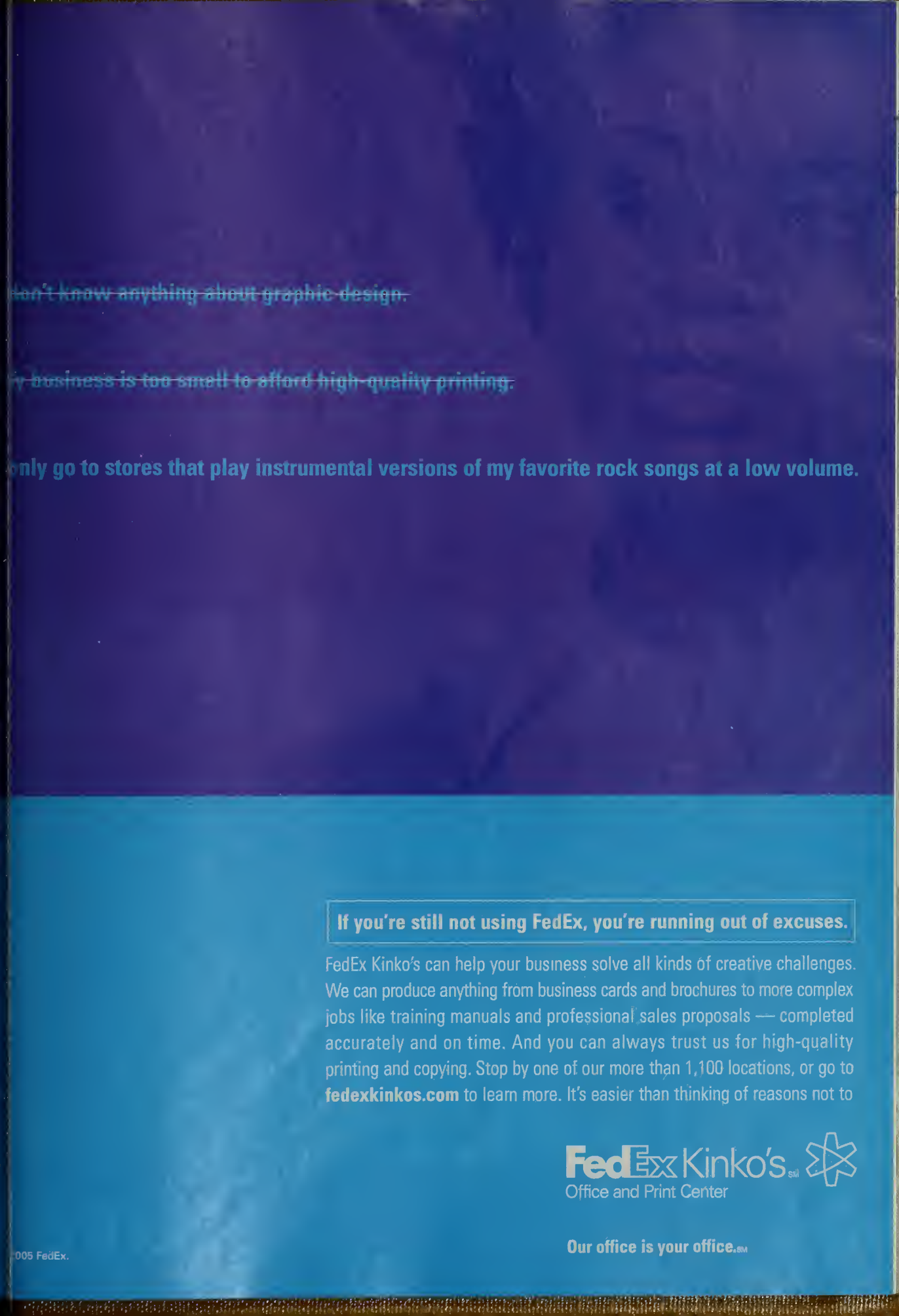
Trained as a painter, Karter got her fi taste of commerce when she return home from Wheaton College to help l dad save his recycling business. Later, s worked as a lobbyist for the glass indust did a stint in Coca-Cola's marketing d partment, and went for a master's deg from the Yale School of Management. S was painting full-time when she met bu er Suzanne Lombardi in 1994. Karter lov Lombardi's cakes and cookies, and w her then-husband Ayis Antoniou invest $20,000 to launch Dancing Deer. Sales $283,000 in two years and more than do bled the next. In 1999, Karter divorced A toniou and, with other investors, bou his and Lombardi's shares. "It was painful, difficult time," says Karter, "and nearly killed the company."

Now, growth is top of mind. To finan it, Karter sold 10% of Dancing Deer in 20 to Christopher Gabrieli, managing director of Bost private equity firm Ironwo Capital. To reduce the com ny's reliance on the holid rush, she's adding a line of shortbre cookies that have a longer shelf life.

BUSINESSWEEK SmallBiz

Although Karter has had her hand every facet of the business, from develo ing recipes to writing quirky packagi slogans, she's recently hired a marketi officer and will bring in someone to ov see e-commerce and operations. "I kn I needed help," she says. "There are opportunities a day to lose your wa And Karter has no intention of letting l company, or her ideals, get lost. ■

BusinessWeek online For more on entrepreneurs, visit businessweek.com/smallbi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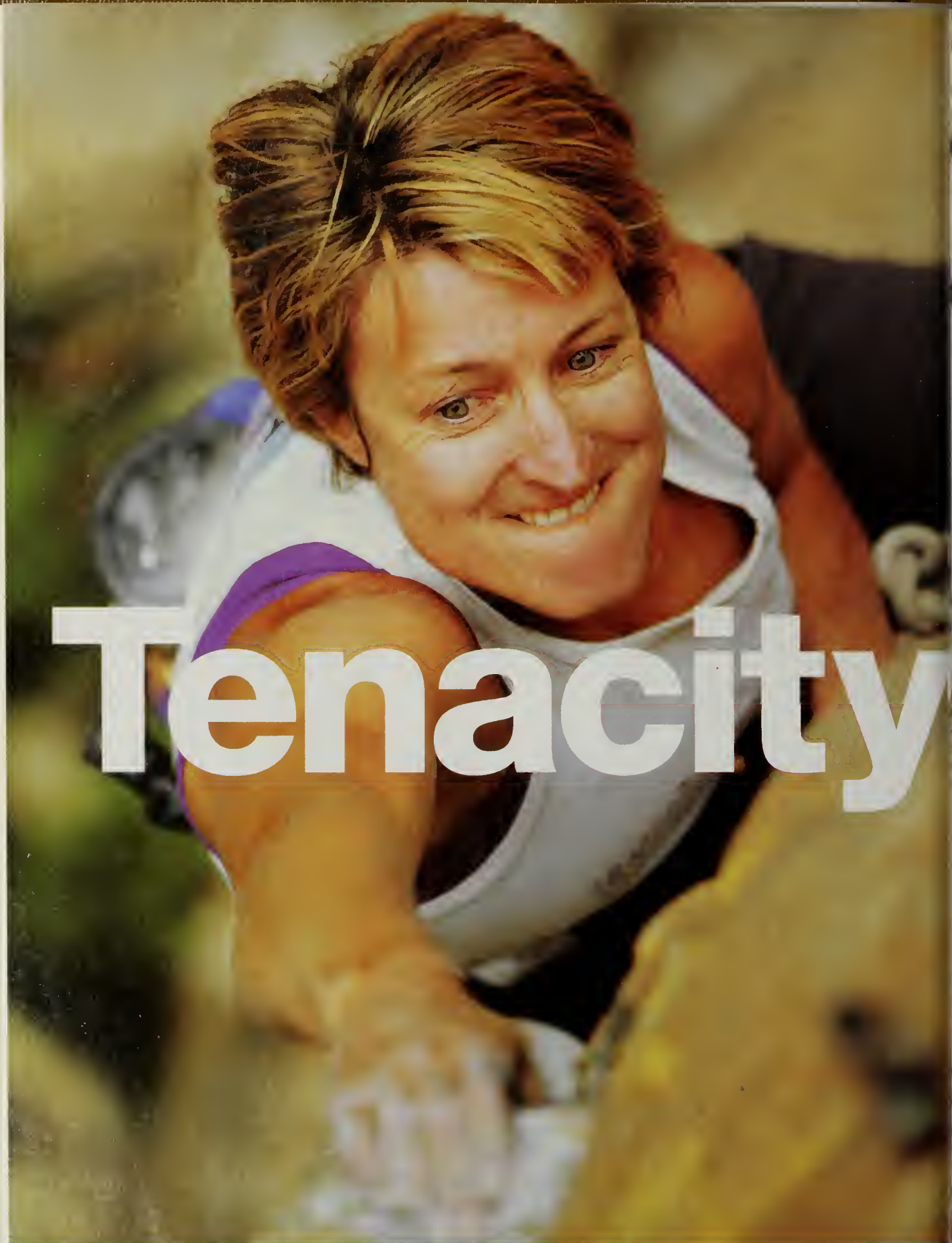

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Make it happen

RBS

The Royal Bank of Scotland Grou

The Competition Issue

What Makes A Winner

AY What would Joe
e know about
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Staubach Whether
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te, preparation is
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Executive Editor John A. Byrne talks about competition with Economics Editor Peter Coy in a podcast interview

BusinessWeek online

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Joe Torre On Winning

Don't be afraid to fail, encourage your talent, and use your heart. And never be unprepared

COMPETING AT THE HIGHEST level is not about winning. It's about preparation, courage, understanding and nurturing your people, and heart. Winning is the result.

To emphasize the importance of preparation, I make my players recall a painful memory from the fourth game of the 2004 American League Championship Series. We were up three games to none against Boston, and carrying a one-run lead heading into the last inning of the fourth game at Fenway. Mariano Rivera was pitching when he walked the leadoff batter. Boston decides to put in a pinch-runner, a guy named Dave Roberts, who would change the tide of the game and the entire series when he steals second. Bill Mueller comes to the plate, hits one through the middle. Roberts scores to tie the game. The Red Sox would go on to win it 6-4 and fight their way back to take the championship. Roberts hadn't had an at-bat all series, but he was prepared to do the job being asked of him. As tough as that game was, I use it and Roberts' performance as an example to my players. You may be frustrated by not playing—that's my decision. But you have to understand when I put you in, you had better be ready to play because everybody in that clubhouse is r lying on you. There will be a time whe everyone on the team is going to contribute to winning a pennant.

As a member of a competitive team, you want to make sure you have yourself ready to play. You don't control an thing but what you do. As a manager, you are responsible for everybody. You're the final decision-maker. It's tougher to do what I do here, but, I wi tell you, hitting with the bases loaded no day at the beach either. After 25 years of managing teams, the last 11 with the Yankees, I have learned not t live in the past and dwell on somethin that failed. The great UCLA basketball coach John Wooden told me once that you can be prepared and have the bes talent there is, but you can't necessari control the outcome.

I believe anybody who is not afraid fail is a winner. I remember seeing my older brother, Frank, playing for the Milwaukee Braves in the World Series in 1957 and 1958 against the Yankees. look back and admire him so much be cause he never seemed to worry about leaping to that next level. He just seemed to thrive in the pressure, neve asking himself "what if I fail?" That's why having perspective is so importa If you talk about game seven of the World Series, it becomes so enormous that it scares the heck out of you. If yo take it to a level that it is a baseball ga and that one of two teams has to win, of a sudden your chances are better.

These days it is so important for a CEO, or any manager, whoever it is, to be aware of his or her personnel. We a in an age of computers, and everythin is so damn impersonal. But in the end it still comes down to people. You hav to make people feel necessary. Even if their contributions are minor, it adds everything else. That's what makes th machine work. I love players with hea not necessarily emotion, but those wh deep down are driven by something more than mind and body. I don't pla favorites. The 25th member of the squad is just as important as the first

. And I can't let my own emotions in the way of competing. I have had elease guys I loved, and keep players dn't necessarily care for.

played and managed in more than 00 big league games before I ever to a World Series. But all that expe- ıce without a championship helped prepare for what I needed to do en I came to the Yankees. When I t accepted the job at the end of 1995, brother Frank said I was crazy. Oth- were writing about how I wasn't ca- le of doing this. All I knew was that rge Steinbrenner was the guy who s going to give me the tools. Then it s up to me. I wasn't afraid of the llenge. I saw it as a big opportunity. l, even with all the talent and re- rces we have here, having heart is at really makes a difference. As a nager, or if you're running a company, want to know that you can ask somebody to do something and that they are going to find a way to get the job done. That's the essence of a competitor.

The toughest decision for any real warrior is deciding when to step away from the fight. I always think to myself that if February rolls around and I'm not excited about going to spring training, it's time. It never happens. A few weeks ago we won a real nail-biter down in Texas and afterwards my stomach was burning. It was the first time in years that my stomach burned like that. One of my coaches, Larry Bowa, said to me, "See? You still want to do this." I do love the feeling of a big win. But again you don't have to have a World Series ring to be a winner. A winner is somebody who goes out there every day and exhausts himself trying to get something accomplished. Being able to get the most from their ability. That's what characterizes a winner.

"YOU DON'T have to have a World Series ring to be a winner. A winner is somebody who goes out there every day and exhausts himself trying to get something accomplished."

The Poll

1. Who is likely to ge

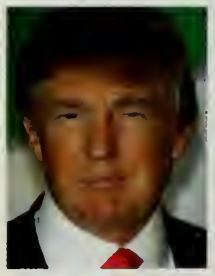
A modestly talented but extremely competitive person. 6

EDITED BY PETER COY

AS A KID, you tipped over the checkerboard when you were losing. Now, you'll f a good friend to get ahead at work. You say you eat nails for breakfast. You thi Tony Soprano has better management advice than Peter Drucker. You belong t small and not always appealing minority: the ultracompetitive.

This poll is for you. *BusinessWeek*'s survey of 2,500 U.S. managers and executiv found that the most competitive are the highly paid, the young, and men. Amo the highly paid, 30% (vs. 22% overall) would fire a friend. Nearly half of peo under 35 like the idea of laying off the bottom tenth of performers in a compa every year. Women? They're just a tad cynical. Only 41% think talent is a k quality for winning in business; 72% name "self-confidence."

2. Who is the world's most competitive businessperson?



Donald Trump **28%**

Bill Gates **24%**

Warren Buffett **3%**

Jack Welch **1%**

Larry Ellison **1%**

3. What is the most competitive company in the world?

Microsoft **33%**

WAL★MART **5%**

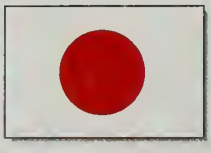
GE **4%**

IBM **3%**

Coca-Cola **2%**

4. What is the most competitive nation?

U.S. **42%**



Japan **21%**

China **19%**

India **1%**

Korea **1%**

Survey of 2,509 Americans in middle management and above, 25 years and older, conducted by Beta Research Corp. of Syosset, N.Y., for *BusinessWeek* during July 13-17, using an online panel. Margin of sampling error is plus or minus 2%.

head at your company?

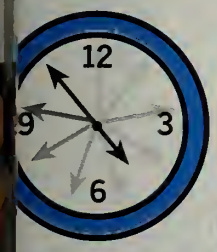
xtremely talented but uncompetitive person. **34%**

How many urs a week you usually rk?

) hours or more: **13%**

HOURS BY INCOME

er $75K	9%
K to $149K	12%
0K and up	21%



Which of e following ngs have u done work?

- one into the office a weekend **91%**
- ssed the start te of your cation **38%**
- ssed an important ent in your ild's life **35%**
- ssed a birthday or niversary dinner th your spouse **33%**

7. How often did you check work e-mail on your last vacation?

Never **33%**
Less than once a day **27%**
Once a day or more **40%**

8. How competitive do you consider yourself?

	MEN	WOMEN
I eat nails for breakfast	11%	3%
I would eat nails for breakfast if I thought it would make me into a CEO	24%	18%
I don't even want to think about eating nails for breakfast	65%	79%

9. If you had to choose just one option, would you rather have the people who work for you...

10. What are the three qualities that are most likely to help people win in the business world?

	MEN	WOMEN
Self-confidence	66%	72%
Integrity	59%	58%
Self-discipline	51%	52%
Talent	49%	41%
Aggressiveness	30%	31%
Political savvy	24%	22%
Self-promotion	11%	16%
Ruthlessness	6%	5%

11.

22% would fire a good friend in order to get ahead at work.

12. Who would make a better CEO?

Captain of your high school football team **29%**

The class valedictorian **64%**

The homecoming king or queen **7%**

13. When you were a child, did you ever tip over the checkerboard because you were losing?

AGE	25-34	35-44	45-54	55+
Yes	38%	29%	25%	22%

14. If your dog is beating another dog in a fight, do you pull it off or let them go at it?

Pull my dog off **92%**
Let them go at it **8%**

15. Which of the following things would you do to get ahead?

	MEN	WOMEN
Go back to school	72%	80%
Take overnight business trips once a week	62%	53%
Accept an assignment to China or India	31%	21%
Hire a performance coach	23%	27%
Have cosmetic surgery	4%	8%
Undermine your boss	4%	2%
Take performance-enhancing drugs	3%	1%
Sabotage a colleague	1%	1%

(CHECKERBOARD AND CHECKERS) ROGER KENNY; (DOGS) INGRAM PUBLISHING/SUPERSTOCK; (FOOTBALL PLAYER AND GRADUATE) CORBIS; (PROM KING) GETTY IMAGES; ILLUSTRATION BY ALBERTO MENA/BW

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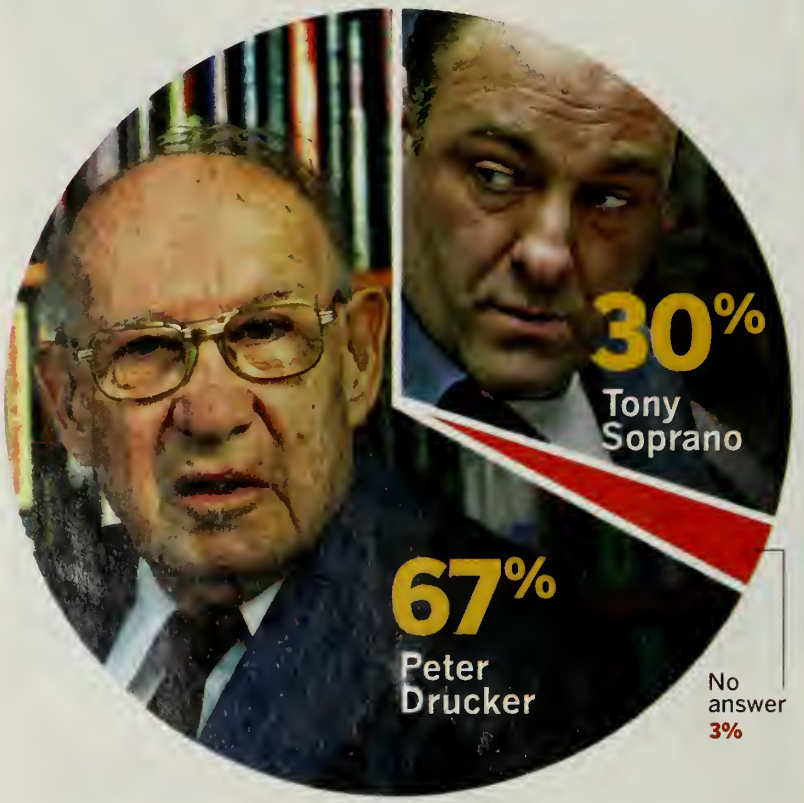
16. **45%** of young* workers think it's a good idea to fire the bottom tenth of performers each year. *ages 25-34

17. Which work objective gets you out of bed in the morning?

	MEN	WOMEN
Knowing you did your job well	44%	47%
Achieving a good balance of work and home life	30%	30%
The respect of your peers	11%	10%
A high salary	9%	10%
Beating the competition	6%	2%

18. Who has more useful management advice?



19. Which part of your company has the most competitive employees?

Sales	38%
Operations	21%
Executive suite	15%
Marketing	9%
Human resources	3%
Accounting	3%
Legal	3%
Finance	3%
Strategy	2%
Research	2%

20. Which of the following things have you done?

Yelled at a referee or umpire at your child's game **28%**

Thrown something at the television while watching sports **27%**

Yelled at your child's coach **7%**

21. Which of the following would make you happier?

You get a $20,000 bonus, but it's the smallest bonus in your group **59%**

You get a $10,000 bonus, but it's the biggest bonus in your group **40%**

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Personal Best

Competing is still about giving it all you've got. But the ground rules are shifting at a quickening pace

JOSE MANUEL VIDAL/EPA/CORBIS

1

WINNING HOW? It's not just about defeating the other guy **Page 52**

STEPS IN TIME Key dates in the individual search for excellence **Page 56**

SELFISH GENES Lessons from the animal kingdom **Page 58**

THE RIVALS How some high-up CEOs were brought low **Page 64**

MONEY MAN High finance's most sought-after specialist **Page 66**

MEADOWMOUNT Notes from the prestigious music camp **Page 68**

BIHAR DIARY How poor kids in India gain entry to the tech elite **Page 74**

THE LIST Our picks of the fiercest competitors **Page 76**

YES, I CAN Ukrainian Viktor Yastreboc's long jump at the European Cup in Malaga, 6/29/06

Yes, Winning Is Still The Only Thing

As this new century unfolds, the competitive urge is increasingly aimed at excelling in everything you do—but not necessarily at the expense of others

BY DIANE BRADY

OF COURSE IT'S ABOUT THE MONEY. But Stephen A. Schwarzman built The Blackstone Group into one of the world's largest private equity firms also for the thrill of it. "People have to understand that the game really is to compete and win," says the chief executive, who raised a record $15.6 billion for one recent fund. Rupert Murdoch, the driven chairman of News Corp., likes to put a face to his battles—going after individual foes such as Viacom's Sumner M. Redstone and CNN founder Ted Turner. Then there's actress Jamie Lee Curtis, who says she learned to read upside down "so I could see [on casting agents' lists] what other actresses were coming in for auditions." And when legendary Dallas Cowboys passer Roger Staubach played baseball as a boy, nothing pleased him more than coming to bat with two players out and runners on second and third base: "I looked at it as an opportunity."

35%
missed a key event in child's life for work
Data: *BusinessWeek* Poll

Everyone likes to win. Beneath all the talk about teamwork and balance, all the books on being kind and cultivating emotional intelligence, people still crave to be the best. Call it passion, drive. In the world of competition, few battlegrounds are more intense than the one with the self. The hunger to reach the top, regardless of the obstacles that stand in your way, remains a fundamental force in the success—and, at times, the dark side—of the human race. In a special *BusinessWeek* poll of 2,500 American workers, two-thirds said "a modestly talented but extremely competitive person" would be more likely to get ahead at their companies. Only one-third gave the edge to "an extremely talented but uncompetitive person."

But what motivates people to compete is char ing. During the 1950s and '60s, the goal was climb the corporate ladder. There were winne and clear losers, along the way. The pursuit start to become more personal during the '70s and l yond, as the Me Generation channeled its energ into making money and finding new ways to No. 1. Women came charging into the corpor world, often feeling pressured to adopt a worl holic style. Ambition became synonymous w single-minded, and many combatants allow their obsession with winning in one area to waste to other parts of their lives. Noted geront ogist Ken Dychtwald, author of *Age Wave*, reca one common thread among highly successful e trepreneurs he met several years ago: mise "Their kids were junkies, their wives had l them," says Dychtwald. "They had one horril story after another."

Winning on All Fronts

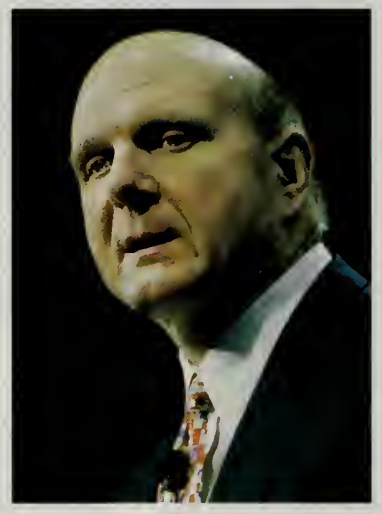
AS THIS NEW CENTURY unfolds, though, t competitive urge is aimed increasingly at winni in everything you do—and not necessarily at t expense of others. Leadership today involves m tivating people, not killing them. Flatter organiz tions reward performance rather than title. A more people pick the places where they compe easily moving in and out of jobs, industries, even the workplace altogether. "Measuring succ against others is a moving target [and] a road burnout," argues leadership consultant Patri Lencioni. Now, adds Keith Ferrazzi, author of *N er Eat Alone*, "it's about distinguishing yoursel Beating your neighbors simply isn't enough.

Today's competitors want it all—career, fami and adventures that push them to new high That's why Martin E. Franklin, chairman and C of Jarden Corp. (maker of everything from D

HOW I COMPETE

Steve Ballmer

Microsoft's CEO has been known to speak first and ask questions later. He eviscerated employees and belittled rivals—but says he's now toning it down.



I don't think of myself in the upper echelon of competitive people I've ever met. My wife finds that beyond humorous. But I've been in environments where people were quite competitive, whether going back to my high school, to college, to the people I worked with as a manager of the football team [at Harvard]. I've been around quite competitive people in my life. But I'm certainly a competitor—there's absolutely no doubt, and I think I'm a very good competitor. I wouldn't want to compete with me. But there are other good competitors out there, too. At the end of the day, I care about our customers. I want them to use our products. I care about the value we add. The only way we get to play is if people choose our stuff.

Of course, competition is the thing that drives everybody to do their very best work, and it's the very best work of competitors that winds up bringing the very best value to customers. So I start with the fundamental premise that says competition is a great thing. At the end of the day it's a measure of the quality of your work. It's like getting a grade. People say they don't like grades, but at the same time people like to know where they stand. If you get picked over a competitor, you know where you stand. And if you don't, you also know where you stand.

Indeed, constantly trying to best previous su cesses is the hallmark of some of the most comp itive people in the world. Witness the sometimes f ger-numbing zeal with which young musicia from around the world work to perfect their p formance and outplay one another at the Meado mount School of Music in the Adirondack Mou tains (page 68). Or the intense discipline th prompted 19-year-old Santosh Kumar to borr books, sell vegetables, tutor others, and study way into the prestigious Indian Institutes of Te nology, becoming a hero in his rural village in t northeastern province of Bihar (page 74). He's co peting for a life no one in his family has ever hac

Like Kumar, members of today's connected ge eration increasingly are driven to achieve mo than their peers. Katie Nolan, 22, notes that when l rowing mates at Bates College agreed to stick togeth in a charity run, it didn't work. "We all started ra ing against each other," says Nolan. Teamwork great, but "we've been raised to believe we'll su ceed in a big way."

Rivals make the game more challenging, see ing as momentary roadblocks or even fuel. though Donald Trump likes to brag about h prowess against the likes of fellow TV star Mart Stewart, his focus is more on the mirror. "I thi of myself as my biggest competitor," says Trum He seems to tally every piece of positive pre every rating point for his TV show, on a men scorecard that may be complete only when l body is in a casket (one brand extension Tru actually refused to put his name on). And In 500 racer Danica Patrick even treats the peop beside her when she's going up a set of stairs as vals. "I compete in everything I do," she says. makes me do my best."

What drives these people? Dopamine, perha since scientists have found that activities such winning tend to prompt a release of the feel-go brain chemical (page 58). Veteran execut coach Marshall Goldsmith notes that the m chronic issue facing competitive people is "th excessive need to win not just the big points b the small points." So they attack a debate ov where to eat with the same intensity as they n gotiate a takeover.

mond toothpicks to Coleman camping gear), aggressively acquires companies and trains for Ironman competitions. "For me, it's all about seeing how far you can go, be that in business, in helping people, or in athletics," says Franklin, minutes after landing in the sweltering heat of Death Valley, Calif., to test out the Kiehl's Badwater Ultramarathon, a 135-mile race that's dubbed the most extreme on the planet. "It would be a very sad day for me to say I can't do more."

es, ambition can run amok. The world is full eople who compete in destructive ways, from otic politicians to greedy corporate titans. t's the dark side of competitiveness, and e killer instincts are often fueled by insecu- desperation, or vindictiveness.

evenge is indeed a powerful motivator. Witness primal drive that has underpinned the come- s of executives such as Millard S. "Mickey" der, who refused a massive payout after being sed to leave retailer Gap so that he could make nark by reviving rival J. Crew (page 64). Other ple may not even know what they seek—but tever it is, they don't want others to get it first.

mune to Failure

BE SURE, YOU NEED more than competitive it to win. Adrenaline and ambition are useless s without the right strategy and talent. As in Menkes, author of *Executive Intelligence*, it: "A lot of people run full speed with incred- urgency in the wrong direction." And some- es there just aren't many prizes being handed Consider the stakes for being hired by one of country's top quant funds: Even with filters like 300 math SAT score and top grades in math, sics, or computer science at the world's most schools, the odds of getting an offer can be 1 in 500 (page 66).

What true competitors have is a remarkable im- nity to the prospect of failure. It's simply not a or and, when it happens, it doesn't take them of the game. Amid this single-mindedness and sweat and the zealous disregard for obstacles n stands a spirit of indefatigable optimism. se people pursue the prize because they are sure can get it. They're less afraid of striking out not taking every possible turn at bat that es their way. "Successful people are delusion- says Goldsmith. "They're not as good as they k they are, but they have the confidence to pur- big things."

n short, they are the kind of people you want on r team. When somebody is passionate and en by the pursuit, he tends to inspire passion in ers. And fortunately for those less driven, most competitors are less interested in bringing others down than in raising themselves up. These aren't the victims or complainers who have been beaten by life. More often than not, they like their bosses. In fact, they want to be the boss some day and often turn him or her into a mentor to help them get to the top. Whether racing to discover an AIDS vaccine or sweating to make it big in Beijing, this century belongs to the people who want the most. ■

HOW I COMPETE

Anne Mulcahy

The CEO of Xerox Corp. tells her sales force of 8,000 that they'll win more selling what's great about Xerox than by dissing the competition.

Competition gives you a focus. Lots of times you need a mission, a bullseye that keeps you focused, and competition can do that. A passion for winning when it's focused on a strong competitor provides a lot of incentive and passion and pride for people. But having said that, it can't just be about competition. There's a whole stream of ways to be successful, and some of that is by focusing on competition and some of it is by taking advantage of opportunities that haven't been exploited.

Generally speaking the toughest competitors are the ones that embed themselves in customer relationships. It's never just about what they sell. It's about the trust that they've established with the customer that says no matter how good what you have is, it's very difficult to unseat that trust. That's really what we're trying to do.

We take apart every element of a competitive [product] to assess the strengths and weaknesses and how we can compete to win. We literally have teams of people who gather, collect, and prioritize competitive information and send out competitive alerts. And when it's important to, [we] create the workshops that are required to arm people with the knowledge of how you win against a particular competitive offering. You have to invest in and develop the capability to systematically acquire competitive information very quickly and be able to react and respond to it.

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Timeline

Society is usually the better for the competitive instinct, that raw urge to beat the other guy. Sure, sometimes it can get nasty. But where would we be if it didn't? Some notable moments in personal competition

BY BRIAN HINDO AND MOIRA HERBST

Biblical Era

Sibling Rivalry

Individual competition begins in earnest, when Cain, angered that God inexplicably favored younger brother Abel's sacrifice over his own, murders Abel.

476 B.C.

Olympic Promotion

Wealthy political leader Hiero—winner of the horse race in the 476 B.C. Olympics—commissions a laudatory ode from

celebrated poet Pindar. Sports marketing is born.

1206

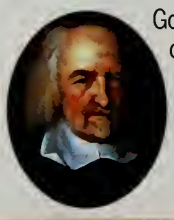
Khan's Conquests

Warlord Genghis Khan (left) unites the tribes of Mongolia under one rule and embarks on a lifelong career of brutal military campaigns. With innovations like merit-based promotions, light silk uniforms, and a flexible command structure, Khan's armies sweep across the Asian continent, laying the foundation for the largest contiguous empire in history.

1651

Taming The Beast

Thomas Hobbes (right) publishes *Leviathan*, which says that man's natural state is anarchic competition. In his self-interest, man forms peaceful societies via the social contract, without which life would be "nasty, brutish, and short."



1789

The Father of U.S. Industry

Onetime textile apprentice Samuel Slater arrives in the U.S. from England. Having stolen most of his former employer's technology, he builds the fledgling nation's first successful cotton mill in Pawtucket, R.I., giving birth to the modern U.S. manufacturing age.

1867

Fight of the Robber Barons

Gilded Age titans Jay Gould and Cornelius Vanderbilt (top, right) begin their battle for control of the Erie Railroad. Vanderbilt buys millions of dollars' worth of stock, but Gould and cronies connive to issue more shares and convertible bonds, diluting Vanderbilt's stake. Eventually Vanderbilt capitulates, and Gould takes Erie into bankruptcy, a corporate strategy he pioneers.

1901

The Big Test Begins

The era of standardized testing begins as the College Board gives its first entrance exam. The SAT arrives in 1926.

1957

The Space Race

Laika, the dog (above) traveling aboard Russia's Sputnik 2, becomes the first mammal in space, raising the bar in the Space Race, which sparked billions of dollars in aerospace research spending.

960s

Competing ad for Kids?

Benjamin Spock's nt) tomes on d-rearing, ch suggest : competition s ad for dren, reach height of their uence. Decades r, youth soccer nes have no winners, eball little leagues 't play with "outs," some schools inate letter grades.

980

ll Gates v. ary Kildall

suits visit Digital earch's Gary Kildall, ing to license his rating system for its fangled personal computer. Legend has it that Kildall, a capricious, brilliant inventor, blew IBM off to take a flight on his private plane, and a young go-getter named Bill Gates swooped in to offer DOS. Kildall later insisted that he had a handshake deal with IBM, but in the tech industry, the affair is remembered (perhaps unfairly) as "the day Gary went flying."

1986

"Greed Is Good"

Ivan Boesky, famed arbitrageur, gives a speech to UC Berkeley students saying: "I think greed is healthy. You can be greedy and still feel good about yourself." He thus sums up the '80s ethos and inspires Gordon Gekko's "Greed is good" speech in the Oliver Stone film *Wall Street*. Within months, Boesky is sent to prison and fined $100 million for insider trading.

1990s

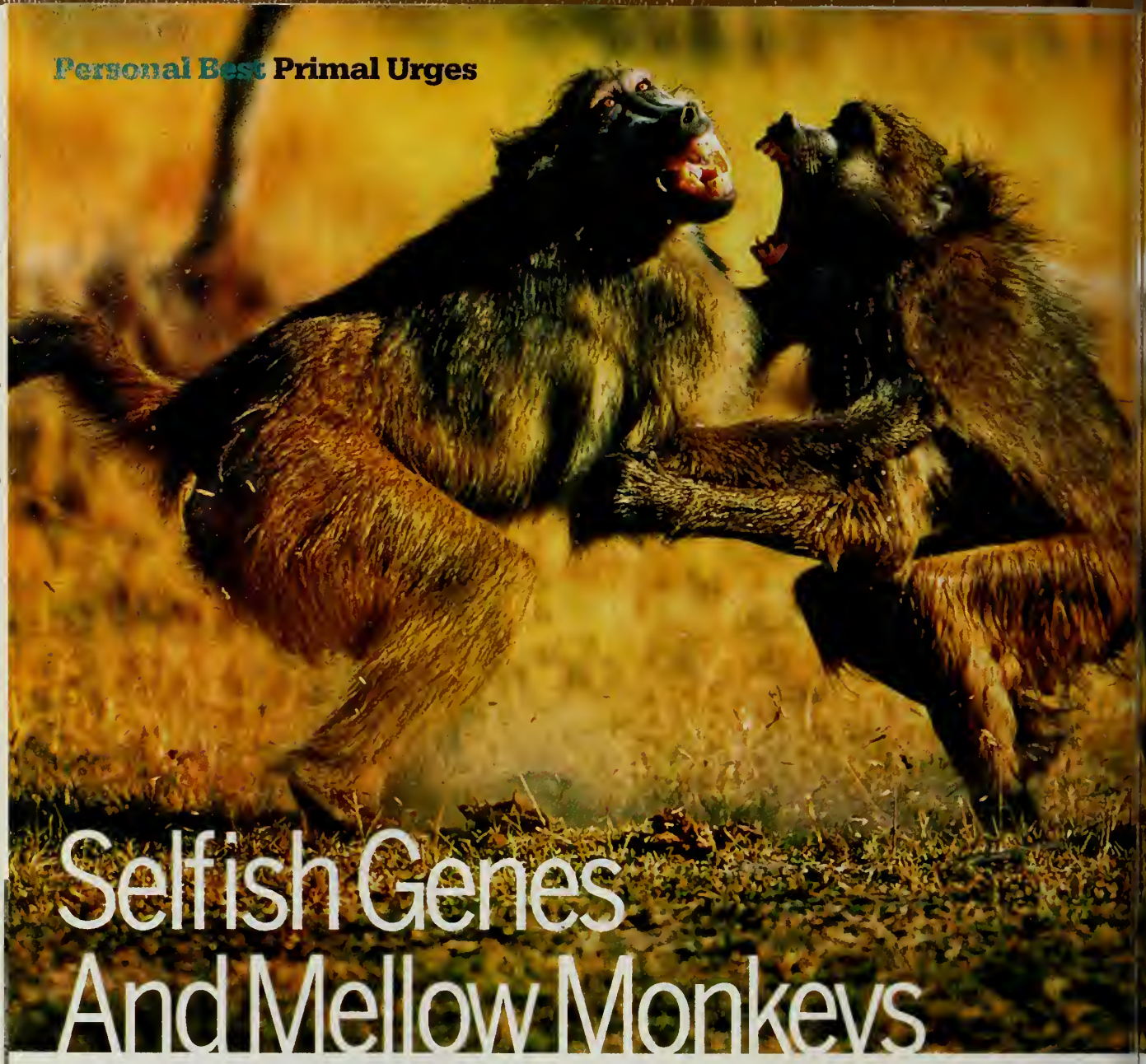
The Legacy of Jack Welch

Ties around the necks of middle managers across the U.S. feel a little bit tighter as General Electric CEO Jack Welch's practice of sweeping out the bottom 10% of performers gains wider acceptance.

2000

Who Survives?

Survivor (right), a CBS show that flung 16 people on a remote island for various physical and mental games, quickly takes the No. 1 slot in the ratings. It ignites the reality TV genre, which pervades popular culture. "Voted off the island" and "immunity challenge" enter the American lexicon.



Selfish Genes And Mellow Monkeys

Food and sex are what drive all animals, including humans, to compete. Even a retiree-turned-couch-potato can't lose the impulse

BY CATHERINE ARNST

IF YOU WANT TO UNDERSTAND THE URGE TO compete, consider the rat. Male wild rats fight each other as a matter of course. When an adult male so much as tries to enter territory already claimed by another, there is a battle royal. The losing rat dies soon after—not from any wounds, which are usually superficial, but from sheer humiliation. Rats, in other words, are about as competitive as you can get.

Except when they don't have to be. Put a bunch of male rats in a cage with no females, give them plenty of food, and they get along like they're on some sort of male sensitivity retreat, grooming each other and curling up together.

Yes, it's true. The drive to compete, hardwired into every animal on earth—the drive that und lies every sporting event, every startup, every ca paign, every war—is all about food and sex. We just trying to stay alive long enough to pass on genes, and if that means fighting to the death o some juicy morsel or juicy mate, so be it.

The drive to survive is the reason brains even ist. In every species the brain is located near mouth. It's rather fitting, because the thinking gan evolved as a way to control movement, mak it easier to go after food and to remember wh the food is. Evolution was even clever enough make eating fun. There are few things more sa fying than a full belly, so animals, including l mans, want to fill it up over and over.

Ultimately, though, the reason living things are so desperate to find food is to ensure their survival. And that, in turn, is all about continuation of the species. Which brings us back to sex. James Brown had it right—almost—when he sang about being a *Prisoner of Love*. More precisely, we are prisoners of our genes' desire for love. These demanding bits of DNA have a competitive instinct unmatched by anything in the natural world, and they are competing for one thing only: that their hosts survive long enough to procreate and replicate the genes in other, equally survival-minded hosts. Oxford University professor Richard Dawkins' 1976 book summed it all up in the title: *The Selfish Gene*.

All About Me

HOW SELFISH IS it? Consider the male marsupial mouse. Once it mates, it dies, in order to free up resources for the next generation. Or how about the male elephant seal: He is so busy from December through March fighting for fertile females that he barely eats, risking starvation. And it's not just males that have selfish genes. Females throughout nature will fight to the death to defend their young, unless they think those young are too weak to ...e, in which case they may kill them.

...Human brains have evolved over millions of ...rs to the point where we can overrule the baser ...incts of our genes. We've figured out, for the ...st part, ways to survive with a minimum of dis...fort and relatively few mortal battles. Still, we ...'t seem to lose the urge to compete. We are ...ped in a "hedonic treadmill," as identified in ...5 by psychologists Philip Brickman and Don... T. Campbell. They realized that our brains do ... recognize an absolute level of satisfaction. In ...er words, no matter how much we have, we ...nt more.

...Competition is so deep that even a retiree-...ned-couch-potato cannot eradicate the instinct. ...r most people, life is not that competitive, and ...we seek out competition anyway," says Charles ...Ewing, a professor of psychology at the State ...University of New York at Buffalo. "Watching ...rts, playing cards—everyone has some desire at ...e level to compete."

...How strong that urge is—what separates a ...ce Armstrong or Michelle Wie from, well, you and me—is determined by a stew of hormones, neurochemicals, and environmental factors that come together to spark a Pavlovian response to victory. When you do something the brain likes, such as winning, the brain's reward center is spritzed with a dose of dopamine, a feel-good brain chemical that prompts pleasurable emotions. "People who are extremely competitive get those spritzes every time they win, so they strive to win more and more," says Dr. James B. Brewer, a neuroscientist at the University of California at San Diego. Incidentally, the desire to continue competing is strongest if the victories are sporadic. "Winning every time doesn't shape behavior nearly as much as winning intermittently," says Brewer.

KILLER INSTINCT
Besides man, only baboons and chimps wage war

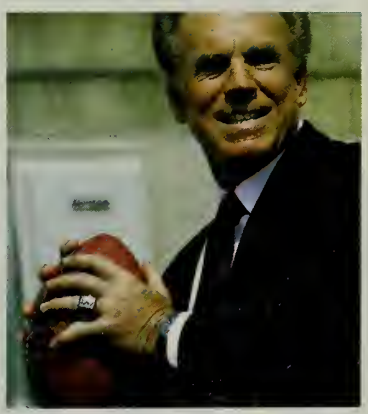
Survival Machine
Every living thing is designed so that its genes win out

Few people do win all the time, of course, and for many the fear of losing brings on unpleasant feelings of anxiety and stress. It's a thin line between the thrill of victory and the agony of defeat, as the hypercompetitive ancient Greeks well knew: Their word for contest was *agon*, the root of the word "agony." Stress ramps up the nervous system, setting up the body to fight or take flight, and the brain is flooded with adrenaline. The ill effects of too much stress are well documented: It wears down the immune system, overburdens the heart, and can kill you. For the mellow among us, that's enough to make us pass the baton to the other guy

HOW I COMPETE

Roger Staubach

After two Super Bowl titles as Dallas Cowboys quarterback, he launched a second career in 1977 as chairman of real estate advisory firm Staubach Co.



When I was young, I was very competitive. I don't know what juices inside of you make you that way when you are little. I grew up [in Cincinnati] playing baseball. When I was seven years old, I was on a really good baseball team called Perkins Bakery. My dad was an assistant coach. He said something to me after a game: 'You really enjoy coming up to bat with two outs and runners on second and third when our team is one run behind. I admire how you like that challenge.' I looked at it as an opportunity.

The most important thing is preparation. I learned that from Coach [Tom] Landry [of the Dallas Cowboys]. You have to do everything you can to prepare to be successful. As an athlete, I really worked hard to be ready for the moment. When the moment came, I had paid the price. It's true in business, too. You work hard to prepare yourself. It takes a lot of unspectacular preparation to get spectacular results. Perseverance and resiliency are the No. 1 qualities in a competitor. Every one of us in life is going to get knocked down. When you are, don't change your values. Don't do something you shouldn't do. Fight with the same principles.

without a second thought.

Then there are the "adrenaline junkies," people who feel more alive when they experience anxiety. What keeps these supercompetitors going? Part of it may be serotonin, a mood regulator that is more prevalent in the brains of aggressive people. Competitors also have higher-than-average levels of testosterone, the male hormone. Studies of both male and female athletes have found that testosterone rises in anticipation of a game, and the levels stay high for some time afterward in the winners. A recent study of amateur hockey players by Justin Carre, a researcher at Brock University in Ontario, found that levels of testosterone and cortisol, a stress hormone, were highest in team members during home games. That hormone surge may be sparked by the urge to defend one's territory, much as a dog defends its yard, suggests Carre.

All of this makes it sound as though some of us are genetically pre-ordained to be alphas, and the rest of us losers. But the environment has a huge role to play in this determination. Women have become much more competitive over the past 20 years as they have gained more opportunities in sports and business. Parenting is also a critical factor in how individuals turn out. Low self-esteem is one of the surest predictors of a poor competitor, and many psychologists believe poor parenting is the surest indicator that a child will have low esteem.

Besides, food and sex don't always have to be vied for in a zero-sum game. Our genes were clever enough to recognize that cooperation can be as effective a survival technique selfishness. The altruistic impu is particularly strong in huma the most social of animals. "Ev in the harshest competition, an telligent organism must be strategist, assessing whether goals might best be served by treat, conciliation, or living a letting live," writes Steven Pink a professor of psychology at H vard University, in his book *H the Mind Works*. "Sometimes t genes' best strategy is to desi organisms that cooperate."

What Makes Sammy Run?

The biology behind the competitive urge

TESTOSTERONE High levels are closely linked to aggressive behavior

ADRENALINE Controls the body's response to stress, speeding up the heart rate and raising blood sugar levels, among other things

DOPAMINE This brain chemical is released in response to a positive experience, such as winning, creating a pleasurable feeling

Making Love, Not...

IN THAT CASE: Why war? In t long run it might seem to be good way to win territory, mat and food, but war is devastati to survival in the short term. I sides man, the only species th exhibit warlike behavior chimpanzees and baboons, with tribes regula attacking each other. But monkeys can chan their "monkeyness" given some peaceful inf ences, as discovered by Stanford University bio gist Robert M. Sapolsky. He wrote in the Janua issue of *Foreign Affairs* about two groups of vanna baboons he studied in the 1980s in Ken One group was getting fat and happy from t garbage they dined on daily from a nearby tour lodge, but they were attacked nearly every mo ing by the most combative males from a fore dwelling baboon group nearby.

It turns out the garbage was contaminated w tuberculosis bacteria. The disease soon killed both the garbage-dump baboons and the forest b boon males that had been elbowing in on th spoils. As a result, the forest tribe was left with o the less-aggressive, friendly males, and double previous female-to-male ratio. "The social con quences were dramatic," writes Sapolsky.

Aggression in the forest tribe was far less f quent. There was more reciprocal grooming a hanging out, and females were less defensive n that there were more of them. But most surprisi outsider aggressor males that joined the tri quickly adapted to this Elysian setting, becomi less aggressive and more social as well. Some years later the tribe's unique social order remai in place, even though all the original laid-ba males have died out. "The most plausible explar tion is that this troop's special culture is not pass on actively but simply emerges, facilitated by t actions of the resident members," writes Sapols

In other words, the resident males and fema treat newcomers well, even if they are aggresso As a result, the new males relax and adopt the b havior of the group. Perhaps culture can trump o genetic imperative to compete—or at least get us stop stealing each other's food.

ELEPHANT SEALS Males are so busy fighting for mates that they barely eat in the winter

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INVESTMENT ALLOCATION, CASH AND LOANS
CAN ALL

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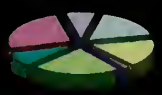

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Don't Get Mad. Get Even

Sometimes it's personal. Executives and boards, managers and mentors, CEOs and chairmen—rivalries can powerfully stoke the drive to succeed

BY SUSAN BERFIELD

CHIEF EXECUTIVES HAVE TO EXPECT A certain amount of public humiliation. They may be chided about their salaries, disparaged for managing problems badly, or held responsible for the disappointments of employees and investors. Those are occupational hazards. Then there are the embarrassments that upend careers and relationships: getting fired, being passed over or pushed into irrelevance. Those are the experiences that can lead an executive to ph lanthropy, a new spiritual practice, or that mo primal response, revenge.

These are stories of three executives: Two we asked to leave companies they helped create; t third was challenged from within. In the mo dramatic telling, they were betrayed or tested the people they most trusted and forced to fi their own way. We don't even need to say they a motivated by revenge. Simple rivalry will do.

The Merchant Prince Prevails

In 2002, **Mickey Drexler** departed unceremoniously from Gap Inc. He had made the company famous during his nearly two decades there, but the retailer had been struggling over the previous three years. He was offered a multimillion-dollar farewell payment from the board of directors—and turned it down. That's because, as part of the deal, Drexler would have had to agree not to work for a competitor. It wasn't pride that motivated him but something more elemental: his sense of purpose in life. Drexler was nothing if not the Merchant Prince; little other than a new throne in the fashion world would do. In early 2003, three months after Gap named his successor, the 58-year-old Drexler moved from San Francisco to Manhattan to run J. Crew Group Inc. It was, he knew, one of the companies whose image and potential could rival Gap's.

Drexler has always insisted he's not motivated by revenge. But he has poached some two dozen Gap managers, and in the fall of 2004 he happily spread the word that Gap's celebrity pitchwoman at the time, Sarah Jessica Parker, had stocked up on J. Crew cashmere sweaters (as gifts, said her spokeswoman). Last year the company's sales rose 18.5%, and in June the retailer went public in one of the strongest offerings of the year.

Meanwhile, over at Gap, Chief Executive Paul Pressler is struggling to avoid becoming the next fashion victim.

A Fight for the Wheel at VW

The fiercest boardroom battle in Europe is a face-off between Volkswagen Chief Executive **Bernd Pischetsrieder** (right), 58, and **Ferdinand K. Piëch** (left), the strong-willed former CEO and now chairman of the "people's car" company founded by his grandfather, Ferdinand Porsche. Although Piëch, now 69, handpicked Pischetsrieder to be his successor in 2002, he has challenged the CEO's decisions ever since. In particular, the two have fought over the restructuring that is under way at VW and Piëch's decision in the late 1990s to start building luxury cars, especially the Phaeton. The car, which starts at $67,000, was Piëch's pet project; this year Pischetsrieder yanked it from the U.S., where it had flopped.

Adding to the tension, Piëch last year acquired a controlling stake in VW and then stacked the board. At this spring's Geneva Auto Show he publicly questioned whether Pischetsrieder's contract would be extended for five years.

Many assumed that meant it wouldn't be. But behind the scenes, Pischetsrieder made a concession or two—nobody is saying just what—and got his n contract. Most likely, he agreed back off from his threat to sell VW's unproductive factories.

Now the CEO has to exert wh power he has to fix the compan before the chairman gets all rile up again. And Piëch? He'll be around as long as he wants.

n Exile from Citi
uts to the Chase

amie Dimon (right) and Sandy Weill. The protégé and the mentor. The two had been together since 1982, when Dimon was hired as Weill's assistant at American Express Co. y turned an obscure loan company into elers Group and then set out to create a banking ire by joining with Citicorp. The new Citigroup Inc., ned in in October, 1998, would have a market value of 5 billion, would become the first global financial ermarket, and someday would be Jamie Dimon's to . Except that it wouldn't. Less than a month later, ll cast Dimon out of the kingdom.

The departure of the brainy then 42-year-old known his command of numbers was called a management keup, an explanation that left everything to the gination. Maybe Dimon fatally damaged his tionship with Weill by not promoting Weill's daughter, ecision that led to her departure from Travelers. Or y may simply have clashed one too many times amid tension of the merger. In any case, Dimon cleared took up boxing, and mulled his possibilities. Sixteen nths later he ended up in Chicago, running Bank One p. After four years of carefully rebuilding the troubled k, he made the deal of his life. He sold Bank One to Morgan, returned to Manhattan, and this January took r as chief executive of JPMorgan Chase & Co. Now he es to refine the strategy he and Weill designed for group and one day take on the company they created.

Thus a new rivalry is born: Dimon vs. **Charles O. nce III** (top), the man Weill, who retired in April, inted to surmount Citi's internal turmoil and estor frustrations.

The Quintessential Quant

Meet the most wanted man in high finance

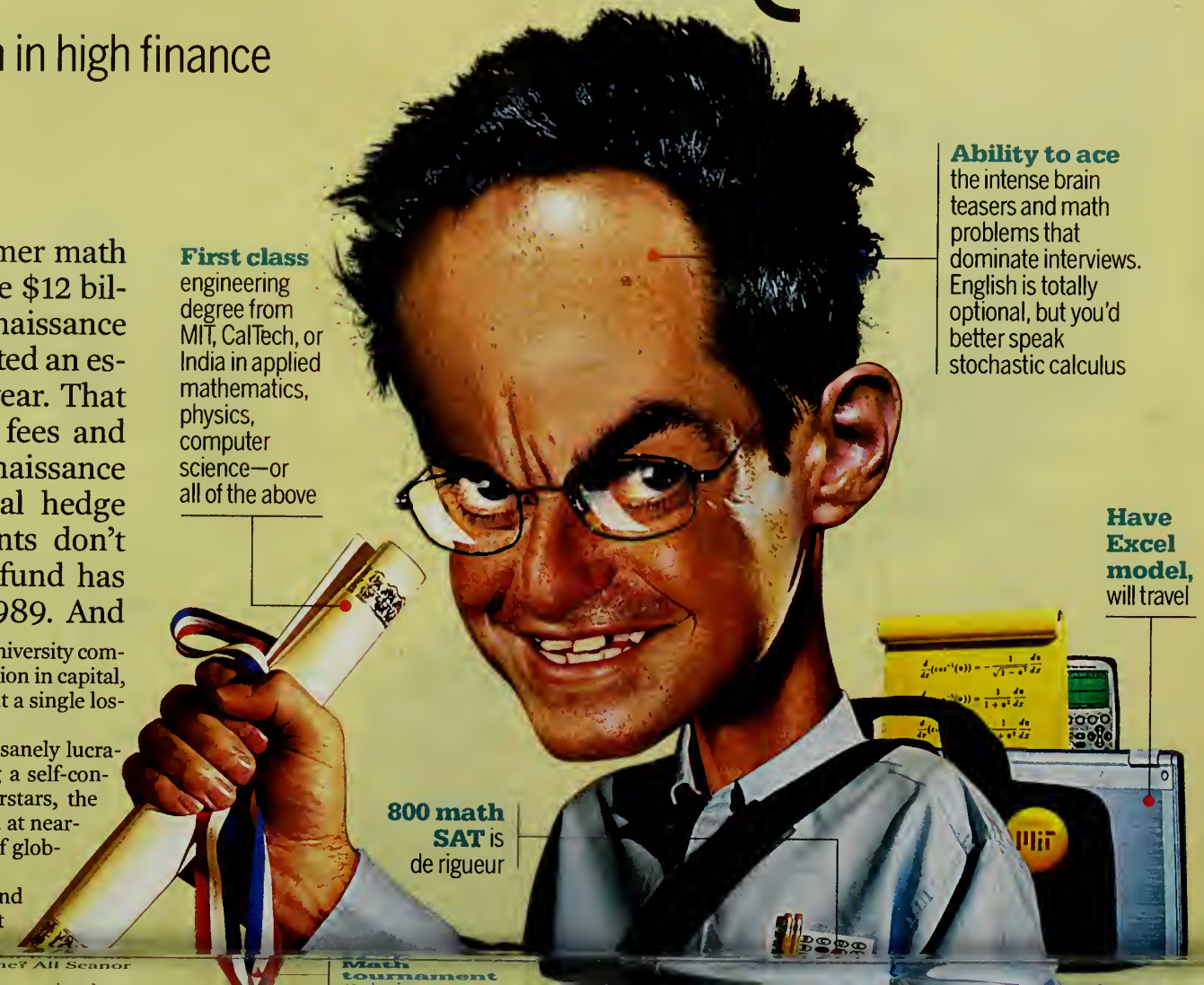
BY ROBEN FARZAD

JAMES H. SIMONS, the former math professor who founded the $12 billion quantitative shop Renaissance Technologies Corp., pocketed an estimated $1.5 billion last year. That was thanks to the 5% in fees and nearly 44% of profits that Renaissance docks its investors (vs. traditional hedge funds' typical "2 and 20"). Clients don't complain; Renaissance's leading fund has returned 35%, after fees, since 1989. And D.E. Shaw & Corp., the brainchild of ex-Columbia University computer science professor David E. Shaw, with $23 billion in capital, has netted investors 21% a year for 17 years, without a single losing 12-month stretch.

Landing a job at either of these shops can be insanely lucrative—and even more insanely competitive. "Using a self-consciously obnoxious term, we're looking for superstars, the kinds of people who would be extraordinarily good at nearly anything," says Nicholas P. Gianakouros, head of global recruiting for New York-based D.E. Shaw.

He is being euphemistic. The handful of quant and programming geniuses who get into the toughest mathematics, physics, and computer science PhD

"it" factor that distinguishes the crème de la crème? All Seanor will say is, "I know it when I see it."



Math tournament

"it" factor that distinguishes the crème de la crème? All Seanor will say is, "I know it when I see it."

One obvious filter is that liberal arts students—or even bankers and stock jockeys—need not apply. What you will need is a nose-bleed grade-point average in applied mathematics, physics, or computer science at an elite school like the Massachusetts Institute of Technology, California Institute of Technology, or Indian Institutes of Technology. Many of these students are published and have won high math honors such as the Putnam Fellowship. Often, their names are already so well known in the field that the quant funds make the first approach.

Another must-have: an 800 math SAT score (even if you sat for that exam in your awkward adolescence). Although the funds diplomatically claim the number is "just another data point," it's pretty well understood to be a critical credential.

The quant shops want malleable intellect untainted by Wall Street dogma—i.e., not "buy, sell, or hold" types. "They're not really looking to make money on corporate events like takeovers," says Emanuel Derman, director of the financial engineering program at Columbia University and head of risk for quant house Prisma Capital Markets. "They're looking to make money on mathematical models." Top funds often advertise in esoteric scientific journals. "You'll not likely find our ads in a dentist's waiting room," says D.E. Shaw's Gianakouros.

If yours is one of the lucky 1% to 3% of résumés to survive an exhaustive initial culling, you can look forward to an hour-long phone interview peppered with thought problems and brain teasers. Pass that test and you will then be summoned as many as three times to undergo up to a dozen grueling interviews. "Every interviewer uses a different approach," says Gianakouros, citing programming problems and math proofs. Expect to be asked to build an intricate Excel model on the spot. Whatever the case, advises Derman, "don't say anything unless you're ready to be quizzed on it."

The firm will then solicit references for areas in which a candidate may appear weak. Ultimately, it takes a consensus among everyone who has met the candidate to extend a coveted offer. D.E. Shaw says that out of every 500 candidates who got the initial callback, only one makes the final cut. Many agree it's even harder to get into secretive Renaissance, which would not comment for this story.

A typical offer, say sources, starts with a base salary of around $250,000, plus a guaranteed annual bonus that could double that. The best can command a cut of a fund's upside—beaucoup bucks when you consider the multibillion-dollar asset pots. All this, yet, says Seanor, "most of these guys have never even had a real job." ■

ILLUSTRATION BY EDDIE GUY

A Boot Camp for Budding Virtuosos

The Meadowmount School of Music, with alums like Itzhak Perlman, proves that hard work can be more important than raw talent

BY BURT HELM

INSTRUCTOR HANS JØRGEN JENSEN BOUNDS up the steps of a beat-up cabin filled with 12 cellists warming up, and suddenly there's silence. "It's showtime!" he proclaims, and technique class begins. The teenage musicians race through scales and shift exercises as Jensen, 56, calls out orders. With a shock of white hair ringing his head and a thick Danish accent, he's an unholy pairing of Larry David and Arnold Schwarzenegger—a grinning drill sergeant. He singles out 16-year-old Alina Lim and tells her to do octave scales. The exercise requires her to play two notes at once, using the side of her thumb for the lower note. As Lim plays, Jensen twists a knob on her cello below the bridge, untuning her instrument—and making the exercise all the harder. "You should be practicing the feeling of knowing how to adjust," he says, as she tries to keep up with the fast-sliding pitch. "You should be trusting your instincts, not memorized positions."

WORLD TOUR Japan's Ryuse Terada, 9, is back for a second summer

Welcome to Meadowmount, Saturday, 9 a.m. Part summer camp, part music school, and part boot camp, the Meadowmount School of Music is strict, austere, and responsible for creating some of the top string players in the world. Though little known outside of music circles, the small, rundown camp in the Adirondacks has trained such luminaries as Pinchas Zukerman, Itzhak Perlman, Joshua Bell, Lynn Harrell, and Yo-Yo Ma. Many more alums are players in top U.S. orchestras or chamber groups. Every summer 220 young violinists, violists, cellists, and pianists head into the woods with dreams of such acclaim.

I took the five-hour drive from New York City to embed myself at the camp for a few days to scope out this breeding ground for hypercompetitive musicians. A lapsed cellist myself, I wanted to understand what separates the truly elite players from everyone else, and discover why this place in the middle of nowhere helps create so many of them.

The camp is on a winding county road that's zoned as part of Westport, N.Y. Founded 62 years ago by Russian-born immigrant Ivan Galamian, a legendary violin teacher and Juilliard School professor, today's faculty enforce his strict timetable. Students must be awake and practicing by 8:30 a.m., and they must sper five hours a day in their tiny, un-air-conditione bedrooms in individual practice. There's no lake swim in, few extracurricular activities, and on five working phones. Galamian built the camp wi as few distractions from music as possible.

Many of the students are already top players f their age. One pianist I met, 16-year-old Russia Viacheslav Kiselev (or just "Slava"), performed times last year. Several have appeared on Nation Public Radio's *From the Top*, a show featurir promising young soloists.

Tough Job Market

BUT THESE KIDS, EVEN the prodigies, face ste odds. Juilliard admits 8% of applicants and Curt Institute of Music only 4%. Once they graduat they face one of the toughest job markets of ar profession. There are six qualified musicians f any open position today in classical music, accor ing to one study. Base-pay for a major national o chestra averages $62,778 for a 39-week seaso says the American Symphony Orchestra League.

A job in a top orchestra like the National Syn phony Orchestra in Washington is even more s lective. The last time that orchestra had one ope ing in the violin section (October, 2004), mo than 320 violinists applied, and 124 auditione

ELBOW GREASE Campers, like cellist Audrey Nadeau (top) and pianist Viacheslav Kiselev, are required to spend at least five hours a day practicing alone

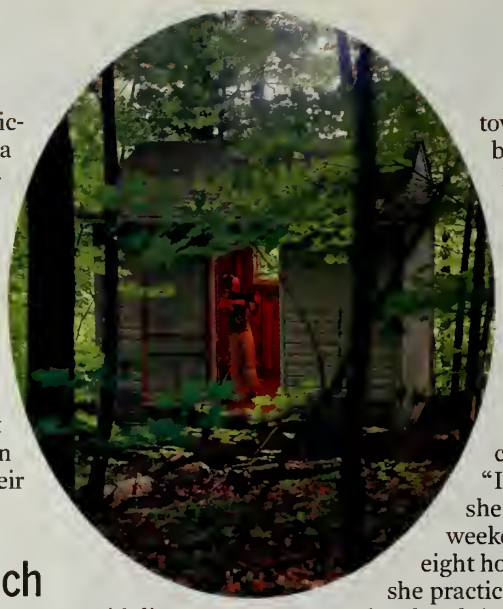
arly every student at eadowmount is determined get a job like that, or better. Why else would you possibly nt to spend your summer this place?" asks one young olinist.

These students place an ormous amount of pressure on themselves. After concert, 18-year-old cellist Audrey Nadeau sits by e front steps of the main house and lights a cigette. She talks about how she struggles to make r cello sound "smooth," practicing bowing for urs to get the sound she wants. She often plays e at night (tonight she will practice from 10:30 til about 2 a.m.), because her muscles are tired, d she thinks that, curiously, it makes her movent more fluid. Recently, she says, she fell on the ad while jogging, right on the shoulder of her w arm. "It hurt so much I could only play with e shoulder very far back. [I realized] that was here my shoulder should be." Everything, even injury, leads her to examine how she plays.

Yet her performance two nights before had unded effortless. Afterward, her teachers marled how she and the violinist, 17-year-old Juilrd student Elly Suh, matched one another's und in the Schubert E-flat piano trio. The group d practiced together at Meadowmount for only 2½ weeks, but they performed as one. "That concert, in many ways, could have been the best I've ever seen here," says Patricia McCarty, the viola instructor at the camp.

After the performance, I'd asked Audrey if she had planned how she would play each occurrence of a key phrase in the piece that repeats in different moods and contexts. No, she says. She listened closely to the other players and adjusted on the fly. It was a direct interface between her musical thoughts and the sound emanating from the instrument. Indeed, the performance of Audrey, Elly, and their pianist, 19-year-old Lawrence Osborne-Quinnette, seemed to come from pure, natural talent—something close to prodigy. These weren't seasoned professionals, they were teenagers. How could it come from anything else?

Scientists have investigated this question of expertise—specifically, skill at a level that seems unobtainable by normal, motivated individuals. In one study, researchers led by Florida State Univer-



NO DISTRACTIONS Meadowmount offers few activities and has only five telephones

sity professor K. Anders Ericsson studied musicians at a Berlin conservatory. Students were divided into three skill levels, including one the faculty had identified as having the best chance of becoming world-class soloists. The researchers had the students keep diaries of their schedules and looked at such information as when they started playing and their practice habits as children.

Different Approach

THE RESULTS WERE CLEAR-CUT, with little room for any sort of inscrutable God-given talent. The elite musicians had simply practiced far more than the others. "That's been replicated for all sorts of things—chess players and athletes, dart players," says Ericsson. "The only striking difference between experts and amateurs is in this capability to deliberately practice." The group even determined the number of hours musicians must play to compete at the highest professional level—about 10,000, the equivalent of practicing four hours a day, every day, for almost seven years.

That finding made sense when I learned more about Audrey. Though she hadn't played seriously until she was about 12, she had gone through a transformation. At 11, growing up poor in a small town near Montreal, she re belled against her stay-at home mother, who was ob sessed with classica music. Yet she felt tremen dously guilty: Aroun that time, she and he four siblings learned tha their mother was dying o cancer.

So Audrey began prac ticing obsessively with cello borrowed from school "I tried to get back the trus she had for me," she says. O weekends, she aimed to put i eight hours a day. During the week she practiced before and after school and at lunchtime. She became very good very fast. By 14 she had won a contest to perform in front of an orchestra.

Psychologists found a second attribute in elit players that is less obvious than sheer hours o practice. While most of us think of practice as th repetition of tough spots (and this is how man young people do practice), elite musicians, the found, took a different approach. They were in tensely self-critical, identifying weaknesses at a incredibly detailed level. They examined the pat tern in which they put their fingers down, the wa their muscles tensed—and they continually exper imented with ways to improve. In other words they were not only musically creative, they wer creative about solving problems.

This is what the teachers at Meadowmount cal "knowing how to practice," something Galamia helped pioneer. In his classic violin exercise boo he breaks playing into several dozen fundamenta skills. Each exercise is a targeted workout, particular rhythm in the bow or finger patter Once all of these are mastered, the reasonin goes, you will have a complete set of skills to pla any piece with relative ease. Says Ronald Copes, violinist with the Juilliard String Quartet who ha lessons with Galamian in the 1960s: "Meadow mount was training in how to listen, and me thodically figuring out how to train yourself t reach what you were hearing in your head. Ronald Lantz, a professional violinist who als studied with Galamian, says he found he "coul learn passages in 10 minutes that used to take m three weeks."

That approach, paired with constant practic and teachers who push their students every day, cre ates an intense environment at the camp. At on point during the weekend, director Owen Carma mentions that the camp allows only the very bes students—about 60—to perform in the camp's con certs throughout the summer; everyone else goe home having paid the $5,000 tuition without on performance. The idea? The students see what possible to achieve but also that not everyone make it. Then, with that mix of inspiration and anxiet they get back to their rooms and practice. ■

HOW I COMPETE

Katie Couric

The longtime host of NBC's Today Show, *will soon take over as anchor at CBS News—the first woman to be solo chief of a network evening newscast.*

Television news is one of the most competitive arenas anywhere. I think the only way to thrive and survive in that atmosphere is to have the love of competition in your blood. You have to want to compete—to get in the race and not give up. I'm lucky. I learned how to do that at an early age. When I was growing up, the President's Council on Physical Fitness invited schools to participate in a nationwide challenge to test kids' fitness levels with things like the shuttle run, the bar hang, and the 50-yard dash. I'd spend the night before rubbing Bengay on my arms and legs, and I'd get my mom to cut my ponytail so there'd be less wind resistance. Soon the teachers were pulling me out of the fourth grade to compete against sixth-grade boys. I didn't always win. But it taught me to love just being in the race, to take joy in giving your all, and to never be afraid to compete. The only thing worse than losing a race is never having the guts to run.

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EVEN THE WINDSHIELD WASHER FLUID IS HOT.

An Awakening In Bihar

How one rural school helps prepare poor youths for the Indian Institutes of Technology

BY MANJEET KRIPALANI

EVERY APRIL, SOME 230,000 INDIAN youths sharpen their pencils and sit for the intensely competitive entrance exam to the Indian Institutes of Technology (IITs)—the seven prestigious schools that train India's top-notch engineers and entrepreneurs. After the grueling six-hour test, only 5,000 students are offered a place in the IITs. Most come from middle-class backgrounds and prepare for the exams through private coaching. But in the past few years, a small group of desperately poor, talented students have made it into the IITs, thanks to the Ramanujan School of Mathematics.

SANTOSH KUMAR, 19, aims for a doctorate in chemistry

The school, named after a famous Indian mathematician, is even more intense than the IITs themselves. Located in Patna, the capital of Bihar, one of India's least developed states, the Ramanujan School trains just 30 students a year to take the IIT exam. Anand Kumar, 33, a local mathematician, and Abhayanand, 52, Patna's deputy director general of police and a lover of physics, founded the school in 2003 to help promising locals get ahead in the caste-based society.

2%
of exam-takers won admission to the IITs in 2006
Data: IIT, *BusinessWeek*

They scoured Bihar's least privileged communities for 30 bright students to coach for the exam, providing free lessons and housing. They call their group the Super 30. "Intelligence is not birth-specific," says Abhayanand. In the first year, 16 of the group made it into the IITs. The next year, 22 made it. "This year," Kumar says confidently, "all 30 will get into the IITs."

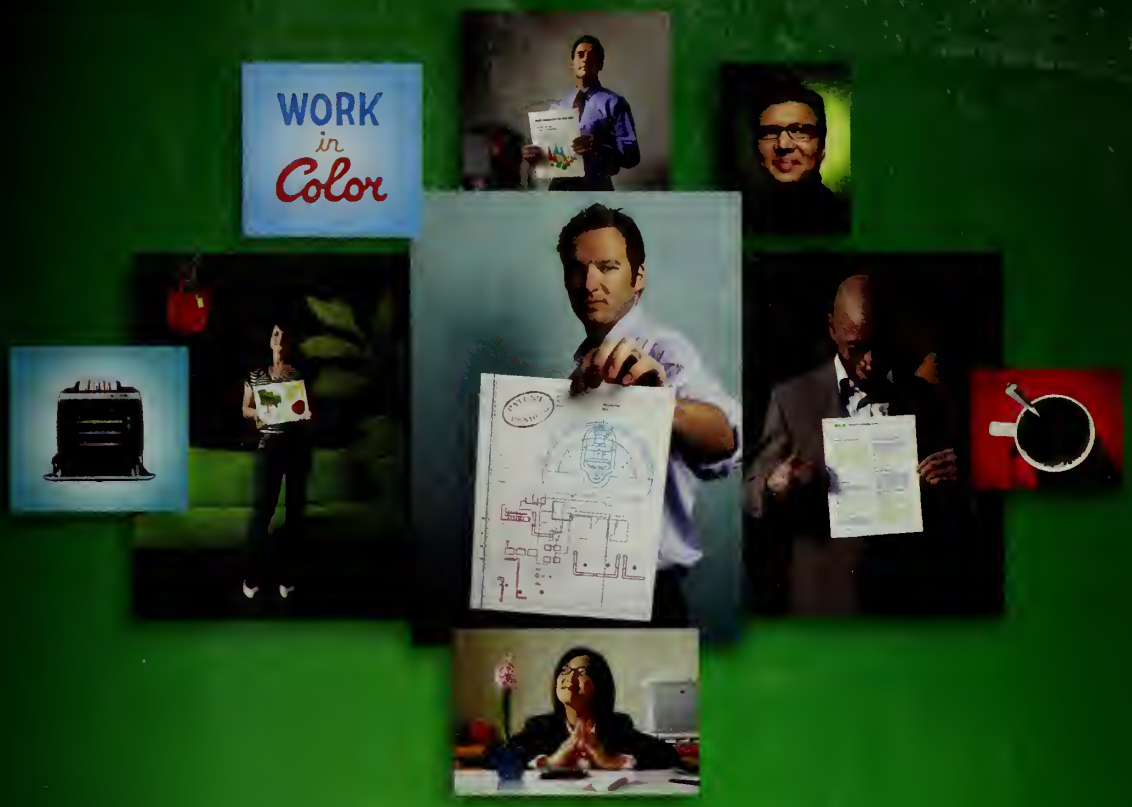
Santosh Kumar, 19 (no relation to Anand Kumar), is one of this year's Super 30, and his story is typical of his classmates. He's from Dumari, a village in the Bihata district, about 22 miles from Patna. Nearly all the village's 3,000 residents scratch out meager livings as farmers. Santosh's sister ar three brothers studied up to 10th grade but then r turned to the fields. "Studying further requir money, so that was that," he says.

Village Hero

SANTOSH WANTED MORE. His school had no ro no doors, and no teachers half the time, but he bo rowed books and tutored two young students f 70¢ a month. He also sold vegetables the fami cultivated in a nearby market town. "I didn't ev know which subjects I was good at, and I'd ce tainly never heard of IIT. No one had," he say Then an eighth-grade teacher noticed his math matical talent and encouraged him to study furth

Santosh saw that "education was the only w out of poverty," he says. At first, he planned to stu so he could become an officer in the Indian ci service. After high school, he enrolled in the Pat College of Commerce, and then he heard about t IITs and the Super 30. "I went straightaway Anand Kumar and told him: 'I dream of IIT, bu have no money.' He gave me his test, and I can second in the class. [He] let me into his Super 30 free," Santosh recalls.

For seven months, Santosh studied every mor ing for four hours, then sat down for a three-ho test in math, physics, and chemistry, and after break studied three more hours. From six to nine the evening, he attended a class in the same su jects and prepared for the next day's test until a.m. His work paid off last spring, when he won coveted seat at the IIT in Kharagpur, near Calcutt (He ranked 3,537 out of the 5,000 students ch sen.) Santosh now aims to earn a doctorate chemistry and become an inventor. His hero is A dul Kalam, India's current President and father the nation's missile program. Just as importa Santosh is on track to be the first person from D mari to graduate from university, making him hero in the eyes of his village.



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TheList

Here are our picks for the most competitive businesspeople on the planet

EDITED BY HARRY MAURER

Larry Ellison

Trying to Be No. 1 At Everything

Larry Ellison, 62, created one of the most powerful technology companies out of someone else's research paper on relational databases, shoestring startup costs, and a take-no-prisoners spirit storied in Silicon Valley. Ellison (drawing, opposite page) built Oracle into a near-$80 billion giant, inflating his own fortune to some $16 billion in the process. So what still drives him? Wanting to be top dog in every arena he enters. **Oracle rules the database universe,** but it's only the second-largest software company, after Microsoft, and Ellison only briefly eclipsed Bill Gates as the world's wealthiest man during the dot-com boom, when Oracle stock was flying high. The ur-Ellison moment: In 2003 he went after rival PeopleSoft in a hostile takeover bid, a rarity in the software biz. A nasty 18 months later he won. He didn't stop there, buying up other rivals like Siebel Systems. Over three years he spent $80 million vying to become the world's fastest sailor but came in second in the 2003 America's Cup. He just capped several weeks in Spain training for the next go-round in 2007.

Dick Fuld

Wall Street Bulldog

Richard Fuld is the type of CEO who has a squash court at home and plays the demanding sport whenever he has a spare moment. He also makes a list of what he has to do every morning and tries not to leave the office until every item is checked off. That helps explain how Lehman Brothers has been able to morph from a struggling bond house into **one of the most agile and aggressive investment banks on Wall Street.** Fuld, 60, has steered Lehman through countless shoals since he became CEO in 1993, including leading an evacuation of its headquarters near the World Trade Center on September 11. Since then, Lehman's stock price has outpaced most of its rivals', soaring more than 100%. Fuld is anything but a remote leader: "If I need Dick Fuld on something, I can usually get him in five minutes," says one staffer.

Bill Gates

Tomorrow, The World

It's hard to think of William Gates III turning his life's focus to philanthropy. Most of his first 50 years have been defined by the zeal with which he turned a dream he shared with high school chum Paul Allen into a $44 billion behemoth that lords it over the software industry. Obsessed with even the smallest competitor, Gates pushed Microsoft to fight for every last byte of market share. He is known to ridicule colleagues in meetings, scoffing: **"That's the stupidest thing I've ever heard."** In two years, Gates will shift his efforts to giving away his wealth and trying to improve the world. He'll no doubt do so with the same unrelenting passion.

Carlos Ghosn

Master Multitasker

Only a true competitor would jump at the chance to run two global companies on separate continents at the same time. That's what Carlos Ghosn, 52, has been doing since last year, when he added the position of Renault CEO to the top job at Nissan, which he joined from Renault in 1999. Combining the two roles means 65 hours of work a week, plus 48 hours a month in the air, but Ghosn still manages to run Nissan's vital North American ops and find time to play tennis with wife. Not that he has eve shirked a challenge. Afte arriving at Nissan he tol investors that he would quit if the sputtering

carmaker wasn't back ir the black by March, 200 To do that, **Ghosn did th unthinkable in Japan:** H trimmed the workforce b 14%, shuttered five factories, broke up cozy ties with group supplier and succeeded. Will he soon get a chance to unleash his energies on General Motors?

Steve Jobs

Apple's Autocrat

To understand Steve Jobs's unique competiti streak, just pick up any Apple product. While mo tech items are built with budgetary constraints ir mind, Apple's **iPods and Macs have the fit and finish of a Ferrari**—right down to Jobs's insistenc that the iPod have no visible screws. But if the

ucts are pretty, his oach to business etimes isn't. Jobs, 51, torious for personally twisting suppliers and rs into granting stiff breaks. The result is many Apple partners, music labels to makers, feel resentful. ve can be charming, ou can never know 's in his brain," says such person. "I don't he appreciates the cept of a win-win." le's customers may to differ.

us Kleinfeld

itting to t Ahead

Siemens CEO Klaus nfeld, 48, being petitive also means wing when to quit. r recognizing that mens couldn't match ia in mobile nology, Kleinfeld aded the company's dset unit to Taiwan's Q. Then he merged his equipment business Nokia's. Kleinfeld, has run the New York athon, then flown night to Germany and in an action-packed at the office, is no ter. **By sacrificing ging businesses, he concentrate on mens' strengths,** such edical systems and er plants—coming er to catching GE.

Rupert Murdoch

A Fighter in Many Arenas

For anyone else, it would have been a painful defeat. For Rupert Murdoch, the 2001 loss of a bidding war for satellite operator DirecTV to rival Charlie Ergen was just the start of the game. After mounting a lobbying campaign to block federal approval of Ergen's bid, Murdoch bought DirecTV at half the price two years later and is now taking aim at rival cable operators with new programs and services. **"I put my hand up in Washington," says the News Corp. czar mildly. "You can't be shy."** That he isn't: Murdoch, 75, has cut a swath through traditional media with audacious moves and well-timed risks. He snatched MySpace.com away from Viacom and has watched the social network site become the talk of the media world. It's simple, really, says Murdoch. "I like to win."

Bob Nardelli

Tough as Nails

Don't have what it takes to meet Home Depot Chief Executive Robert Nardelli's targets? You're gone. **Some 98% of the top 170 executives are new to their positions since he took over in late 2000.** That tough love has delivered results. Revenue has grown 12% per year, and profits have doubled. But the 58-year-old's nail-gun style can backfire. Customer service has tanked, partly because many employees are demoralized. An arrogant snub of "activist" shareholders at this year's annual meeting blew up in Nardelli's face. Humbled, he's working to smooth those sharp edges.

Martha Stewart

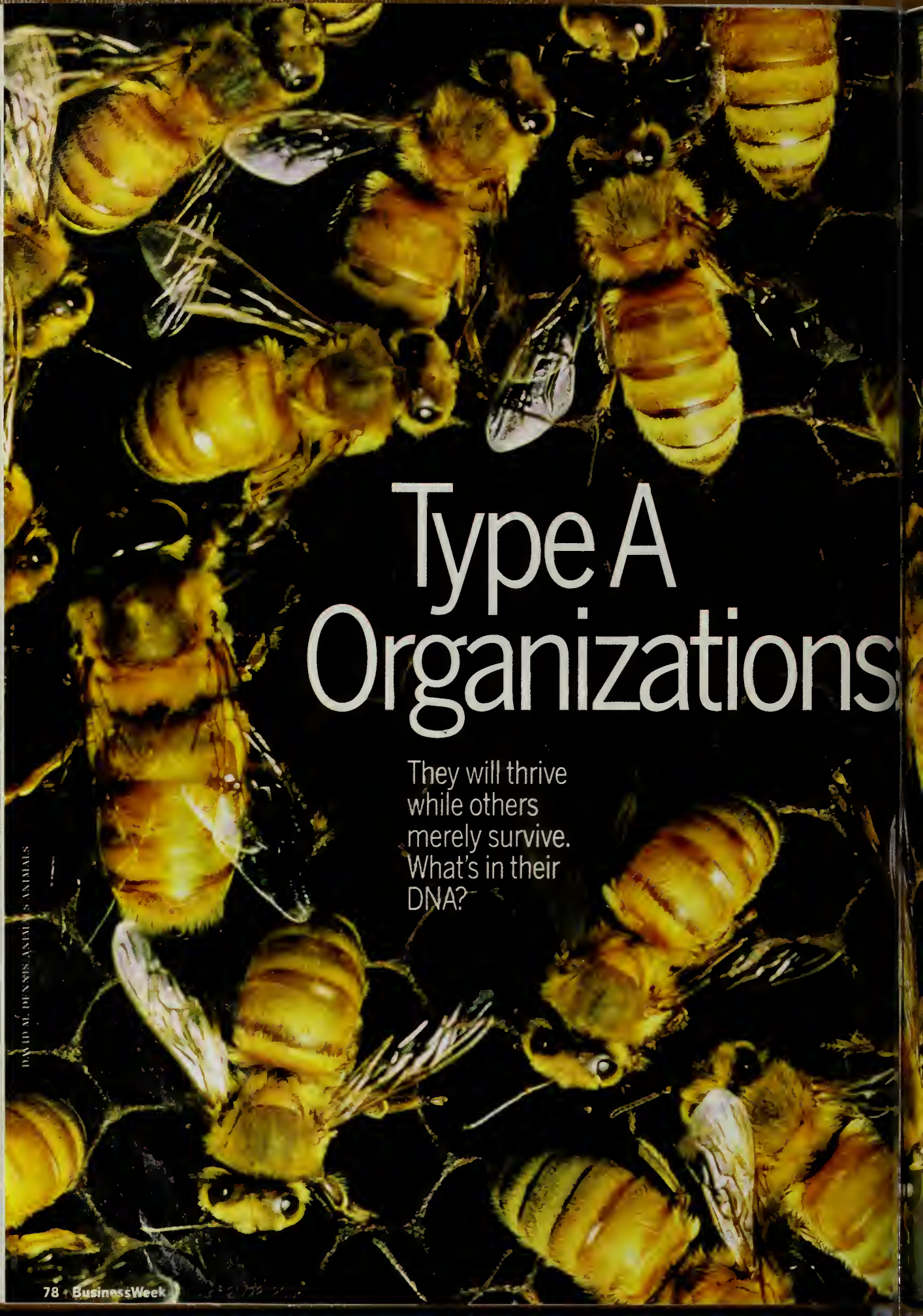
Rebuilding Is A Good Thing

If hosting an exquisite garden brunch was her aspiration, she might have simply made a name for herself in Westport, Conn. But Martha Stewart, 65, always wanted more. Her goal, as she once put it after slamming back a vodka shot with colleagues following a TV shoot at the Russian Tea Room: to teach everyone how to live the good life, then sell them all the gear to do it. Stewart succeeded until she lied about a stock sale, prompting a scandal and a stretch in jail. **Now she has a new crusade: fighting to rebuild her namesake company.** The perfectionist looks more fallible, but she hasn't lost an ounce of the drive that made her famous.

Donald Trump

The Art of Self-Promotion

The Donald may be a shameless self-promoter, but that helps burnish his competitive rep. Through his real estate projects, books, TV show *The Apprentice*, and ubiquitous public presence, he has turned his moniker into a lucrative brand. "In life, you have winners and losers," says Trump, 60 (drawing, opposite page). **"And often it's a small group of people who seem to be the winners."** So how does a man who has been whacked in his personal and professional life keep going? "I think very positively." Moreover, he doesn't exactly kick back after hours: "You're not competitive in one thing and then you turn into a marshmallow everywhere else."



Type A Organizations

They will thrive while others merely survive. What's in their DNA?

DAVID M. DENNIS, ANIMALS ANIMALS

2

THE CHAMELEONS Meet the corporate quick-change artists **Page 80**

STEPS IN TIME A look back **Page 84**

WAR OF THE SATELLITES XM vs. Sirius **Page 86**

TALENT BATTLES GE's fight to keep China's best **Page 88**

PATAGONIA'S PASSION Maximizing motivation **Page 92**

CO-OPETITION Teaming up with a rival **Page 96**

HIGH STAKES Training GIs for Iraq **Page 98**

GO TERPS A miracle in Maryland **Page 102**

THE LIST Organizations that get it **Page 104**

TO BE THE BEST Innovation has to be a 24-hour-a-day job

How to Hit A Moving Target

These days all competitive advantages are fleeting. So the smartest companies are learning to create new ones—again and again and again

BY ROBERT D. HOF

SPEND A WEEKEND PLOWING THROUGH even the best of the 18,038 business books found on Amazon.com that mention the word "competitiveness," and you're left with four things: a splitting headache, two bleary eyes, and a mishmash of utterly random and conflicting advice.

Differentiate your products. No, nothing's unique anymore; just slash your costs. *Sorry, everyone's doing that. Invent new markets instead.* Hug your customers, that's the ticket! *Get real, you wuss—it all comes down to squashing your competitors like bugs.*

The message between all those lines is unmistakable: No matter what strategy you try, competitive advantage—whether it's Home Depot's b box appeal, Intel's chip technology, or Disne magic aura—is tougher to create and sustain w each passing year. Says C.K. Prahalad, professor corporate strategy at the University of Michigan Ann Arbor and co-author of several books on co petition: "Whatever advantage you have, someo will take it away from you."

Yet there's hope behind this harsh truth. As ha as it has become to create an edge, some smart ganizations are finding new ways to do it. Not good, mind you—maybe not even for the years t many companies and their investors have come expect. But a few standouts are managing to do t next best thing: They keep creating new compe

advantages, over and over, faster faster.

Meet the corporate chameleons. y're organizations that have learned djust to rapid social, economic, and petitive changes with relative ease. most successful among them don't le for hunkering down in soul-depleting mar- share wars to protect an increasingly fleeting e. Instead they zig and zag with the zeitgeist to p coming up with new ideas.

periment Fearlessly

D THEY DON'T much care if those ideas nd a little nutso. Analysts still aren't e, for example, about those digital mu- kiosks at Starbucks. And what the heck mazon's Mechanical Turk? (It's a sort online marketplace for farming out all jobs.) But a culture of experimenta- is crucial in a fast-changing world. As azon Chief Executive Jeff Bezos told a up of Stanford University stu- its last year: "Invention al- ys leads you down paths that ple think are weird."

Not that there's much ice. Competition keeps in- sifying around the world. one thing, after decades of ng power, Asian compa- s are starting to run circles und American and Euro- n rivals across a wide va- y of industries. A few rs ago, who would have ught that India's Wipro, osys, and Tata Consultancy Services each would have market caps bumping up against, or even eclipsing, that of General Motors?

Not only that, the Internet is busting the boundaries of many industries, creating openings for unexpected newcomers. With its Net communications subsidiary Skype, for instance, eBay is assaulting telecommunications players by offering free phone calls. Even more broadly, as the Net helps more businesses evolve from merely selling products to providing services, companies are invading markets they could never touch before. Google's new online services, such as e-mail and word-processing, challenge Microsoft's cash-cow software applications. Caterpillar's new logistics services go up against the likes of Ryder and FedEx.

What's most striking is that the classic *mano-a-mano* battles, such as Coke vs. Pepsi and Microsoft vs. Apple, are only one small part of being competitive. From Starbucks and Cirque du Soleil to Caterpillar to Whole Foods Markets, companies are finding new ways to differentiate themselves and create entirely new markets. Many are finding that in an intensely networked age, cooperation works better than direct competition. Leaders know that if they fixate on competitors, they'll miss the real prize. "If you want to do a breakthrough, don't look around," says Daniel Lamarre, president of Cirque du Soleil. "Look ahead."

That's what the best of the bunch are doing. Granted, not all of the practices they em-

ploy will work for every company in every industry or at all times. But in an era when the competitive playing field is constantly morphing, a few key guidelines have emerged for how to stay ahead of the pack.

DON'T JUST GET BIGGER, GET UNIQUE. Dell, Wal-Mart, Intel, Home Depot, and Microsoft: Each dominates its field—and each faces new challenges to growth and profits. Is the quest to be an 800-pound gorilla the smartest strategy? Harvard Business School strategy guru Michael E. Porter doesn't think so. In an age of infinite choice, he contends, there's a better way to achieve competitive advantage. "There is no best auto company, there is no best car," he says. "You're really competing to be unique. One can now be a very, very large company by really meeting a very well-chosen set of needs—but doing it on a global basis."

Whole Foods Markets, for instance, is "not just trying to be a great food retailer," says Porter. "It's trying to meet the needs of a certain set of customers." Those customers view the 183-sto chain's eco-friendly ethos as representative of healthy, socially responsible lifestyle they want identify with (not to mention that they crave tho Medjool dates and organic heirloom tomatoes). It unlikely that Kroger's or Wal-Mart will ever be ab to claim that kind of brand loyalty—even if Wa Mart is out trumpeting its goal of "going green."

WHY COMPETE? CREATE NEW MARKETS. Niches a nice, but inventing a new market is a whole lot be ter. Former fire-eating street performer Guy Lalib erté founded Canada's Cirque du Soleil 22 yea ago on the notion of a unique combination of ci cus (but without the animals) and theater (b more acrobatic). Despite massive global expa sion, with about $700 million in profitable annu sales, Cirque has no significant direct competitor

Cirque's Lamarre attributes the company's edg to a stubborn resolve to "stay crazy" and keep "t suits" away from all creative decisions. To kee shows fresh and get a read on shifting publ tastes, an in-house group called New Tendenci studies what's new in restaurants, car design, fash ion, and other unrelated industries. One resul The group noticed the ascendence of Asia themes, so that flavor was injected into Cirque's h MGM Grand show *Kà*.

This kind of market-making lets innovators fro Cirque du Soleil to Apple to Starbucks avoid mark share wars and reap big rewards, says W. Cha Kim, co-author with Renée Mauborgne of the 200 book *Blue Ocean Strategy*. Their research over th past decade shows that 86% of launches by 10 companies were mere line extensions, which a counted for 39% of profits from all new-busines launches. The remaining 14% represented ne markets, and they generated 61% of profits.

OBSESS ABOUT CUSTOMERS, NOT RIVALS. Heav equipment is an intensely competitive busines but No. 1 Caterpillar keeps its eyes on the priz what its customers want. Instead of just sellin that familiar yellow gear, the Peoria company sel service—or, as its informal motto says, "Buy th iron, get the company."

Caterpillar will ship spare parts to a custome anywhere in the world, from the Alaskan tundra t the deserts of Timbuktu, in just 24 hours. But th dividends of that high level of service extend be yond customer loyalty. The company's variou service contracts serve as a kind of annuity, and th need to arrange distribution of several hundre thousand parts worldwide led it into a profitabl fast-growing logistics business. Even with a recer slowdown in housing construction, Caterpillar sa its second-quarter profits jump 38% and raised it earnings outlook for the year.

GIVE AS GOOD AS YOU GET. More than a decad ago, James F. Moore noted in his book *The Death Competition* that huge, cooperative networks c companies such as the IBM, Intel, and Microsol troika in computing, or Toyota and its close-kn

HOW I COMPETE

Rupert Murdoch

Starting as head of a tiny newspaper chain founded by his late father, the News Corp. CEO built a media giant.

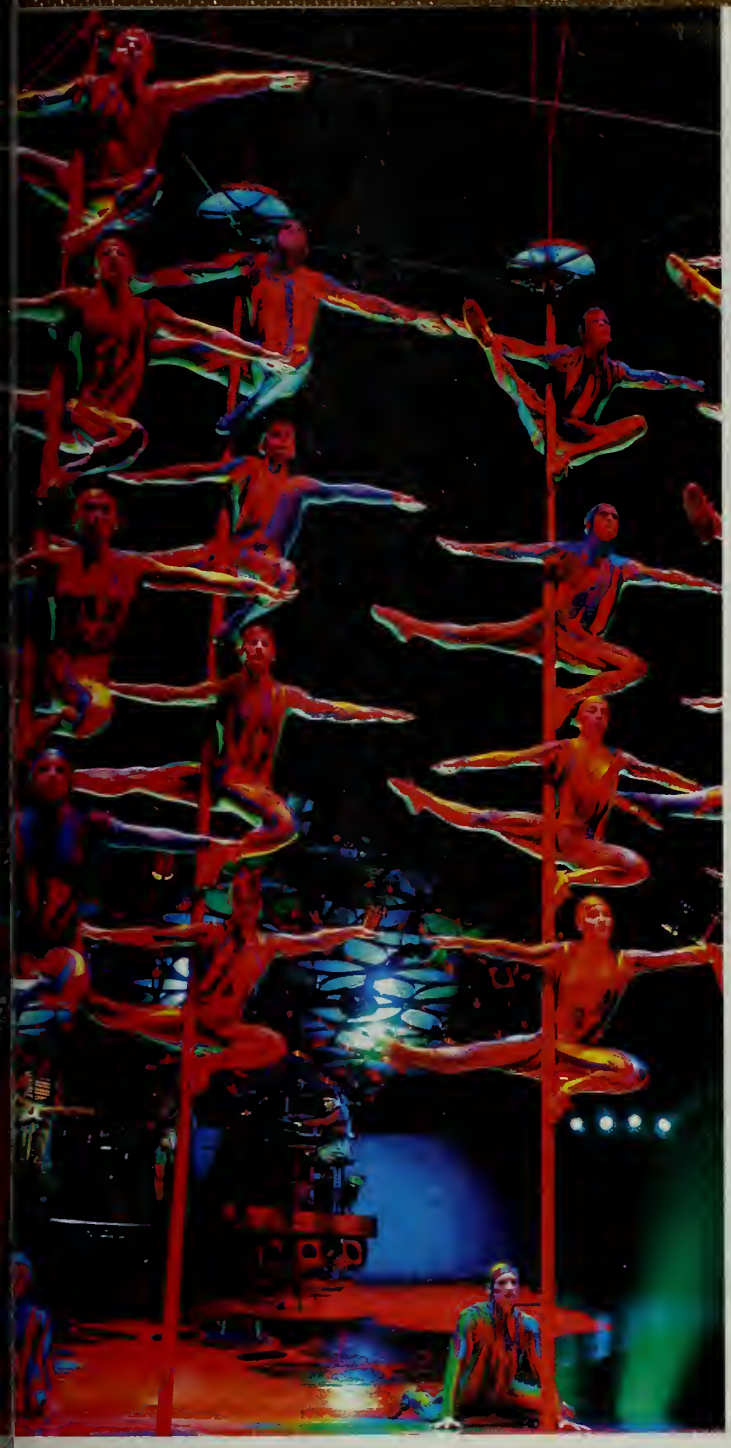
Competition is enjoyable. It's the reason for being in business. You have to like to win. I like to win. My father was more of an editor and publisher. I would have liked to do more of that. But I had to be more concerned with other things, and it dragged me into other businesses. But maybe it's in my genes. When I started, there was a much larger newspaper than us, and we had to compete to survive. You do that with better journalism. And then you have to endure. Stick it out. And we did that.

It's what we've done in New York with the *Post*. There's a tremendous amount of competition in that market, but we've created a superb newspaper, and we're the only ones who go up in circulation at a stable rate.

Probably the toughest thing I have ever done was in Britain when we bought [satellite operator] BSKYB. We saw a real opening. About the only TV people were getting back then in Britain was the BBC and BBC Lite. We felt people wanted better TV and were willing to pay for it. We lost money in the first two or three years. My bankers weren't very happy with me, but we knew that if we could stick with it there would be a huge market, and there is.

We saw an opening for Fox News [in 1996], too. We didn't think CNN was entitled to a monopoly on 24-hour news, and the entire news business had become monolithic, with the three networks and CNN. In the beginning it was tough getting people to carry us. But we did it.

Now we've got MySpace. When we first got it, it looked like we paid a lot for that [and outbid Viacom in the process]. We came into that a little late, and I think Viacom probably thought they had it. But we wanted it more, and I told my people to get it. I like to win, and that was a big win for us.



CIRQUE DU SOLEIL An in-house group studies what's new in a slew of unrelated fields to glean fresh ideas

GET PERSONAL. Thanks to the Web and just-in-time supply chains, the mass-market era is fading as customers begin to tailor companies' products to their tastes. Amazon offers personalized book recommendations based on your literary leanings, Build-a-Bear Workshop lets your kids design their own teddy bears, and virtually every Dell PC is a custom job. "With personalization, you have infinite ways to differentiate," says Prahalad, whose 2004 book *The Future of Competition*, co-authored with Venkat Ramaswamy, urged companies to "co-create" products with customers.

That approach is working wonderfully for Lands' End. Six years ago the mail-order and Web apparel retailer began offering customers the ability to order jeans, men's dress shirts, and other items to their exact measurements. Today, even though the clothes cost at least $20 more apiece, up to 40% of Lands' End customers choose the customized versions. And 33% of those customers reorder the personalized product. Even better, about a quarter of these made-to-measure fans are new customers.

STAY HUNGRY. A low-cost business model isn't much of a differentiator anymore, but staying efficient remains crucial. So is engaging in direct combat when necessary—let's face it, in some industries competition ain't pretty. "It's a hard world," shrugs Boston Consulting Group's George Stalk, co-author of 2004's *Hardball: Are You Playing to Play or Playing to Win?* "It's 'I'm going to eat your lunch or you're going to eat my lunch.'"

18,038
Business books on Amazon.com that mention "competitiveness"

Today, even the most dominant companies need to stay on their toes. The truth is, there's no final winner in the global game of corporate competition. "All winning does is let you compete against a whole new set of better-funded competitors," observes Joe Kraus, founder and chief executive of Web collaboration software startup JotSpot. "Competition never ends."

–With Michael Arndt in Chicago

plier network, were overtaking individual
npanies as new competitive forces. Now a lot of
npanies are taking an even bigger leap forward.
ey're tapping into the cooperative crowds that
ate things like open-source software, eBay's
ssive marketplace, and Skype's peer-to-peer Net
one network.
n some cases they're finding ways to leverage
t cooperative force to huge advantage. Google,
instance, instantly polls millions of people and
sinesses whose Web sites link to one another,
l as a result the company produces better search
ults than its rivals do. That has allowed Google
ontinue gaining market share. It has also en-
ed the company to build a highly profitable ad
siness with $6.1 billion in revenues, up 93%
m a year ago.

Timeline

John D. Rockefeller (right) didn't much care for competition, even if he was vicious in practice. But the quest for a competitive advantage is what drove the birth of the modern corporation, and what has made it flourish since

BY BRIAN HINDO AND MOIRA HERBST

1555

A Company Is Born

The Muscovy Co. (seal) becomes the first joint-stock chartered company, with a monopoly on trade routes from England to Russia. It inspires a host of imitators, most of them seeking dominance on routes from Europe to the New World. Joint-stock structures proliferate during the colonial era.

1670s

The First Multinational

The English East India Co. outmuscles Dutch and Portuguese rivals, reaching the zenith of its powers in the late 17th and early 18th centuries. It emerges as a military force in its own right, occupying nations and minting money. Considered the first multinational, it monopolizes the trade between East and West (below left) in tea, opium, and gunpowder through operational efficiency and ruthlessness.

1870s

Modern Era Monopoly

Thanks to smarts, determination, and the liberal application of kickbacks, bribes, and predatory pricing, John D. Rockefeller builds the Standard Oil Co. into a super-efficient, vertically integrated behemoth. As the company comes to dominate the U.S. oil industry, he is pilloried for monopolistic practices. He rationalized his behavior: "We were all in a sinking ship if competition continued."

1924

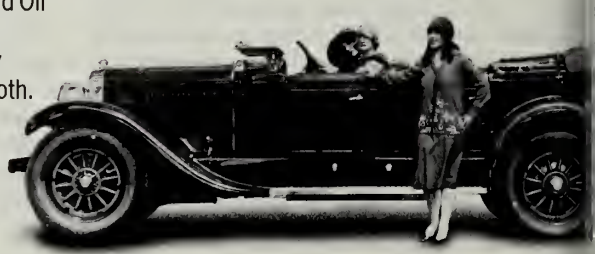
"A Car for Every Purse"

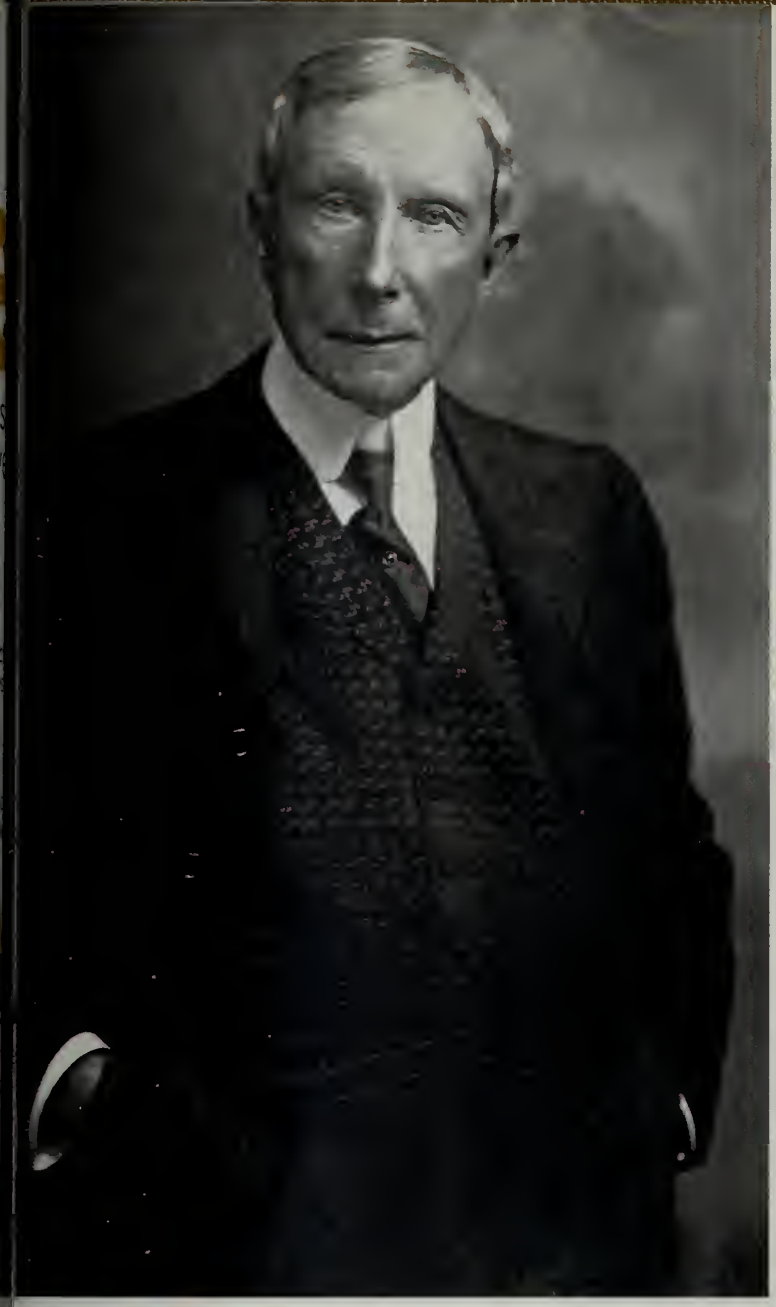
In his letter to General Motors shareholders, Alfred Sloan articulates his product strategy—"a car for every purse and purpose"—from the thrifty Chevrolet to the luxury Cadillac (below). That approach revolutionizes the whole automotive industry and propels GM to t apex of Americ business.

1946

Ford's Whiz Kid

Ford Motor hire the "Whiz Kids," whose scientific, methodical control processes had helped the U.S. wage its air combat in World War II The group, including Charles B. "Tex" Thornton, J. Edward Lundy, and eventual Vietnam era Defense Secretary Robert S. McNamara (on the BW cover above), whipped Ford into shape. On the downside, their tactics made numbers-driven corporatocracy fashior able for much of the latter 20th century.





1969

One Man's Junk...

Michael Milken (right), then a 22-year-old Wharton grad, arrives at Drexel Burnham Lambert. He eventually heads the high-yield-investment-grade bond department. His pioneering work in junk bonds transforms M&A, making DBL Wall Street's most profitable bank and giving rise to the leveraged buyout craze. By 1989, he's jailed for securities fraud.

1978

So Long, Pan Am

In airlines, American business sees the grandest application yet of deregulation. Competition drives more than 10 major carriers and hundreds of smaller ones into bankruptcy. But ticket prices have gone down, and safety is up.

1980s

Marketing Wars

The Soda Wars escalate to dizzying degrees as Coke and Pepsi slug it out. The Good: The Pepsi Challenge, a clever marketing campaign. The Bad: New Coke, a hall-of-fame-level disaster. The Ugly: Crystal Pepsi, the "clear" cola.

1986

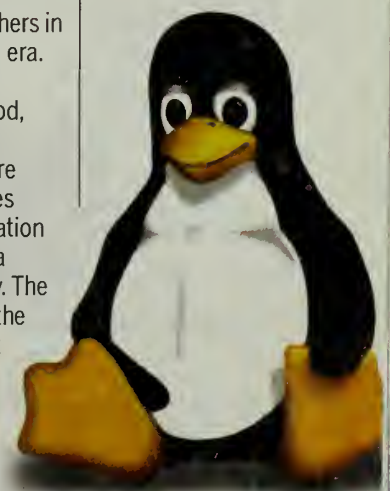
The Six Sigma Wave

Engineer and University of Minnesota researcher Bill Smith arrives at Motorola and implements a quality control program he calls Six Sigma. Quality becomes an imperative, and Motorola's program is widely copied elsewhere—most notably at Jack Welch's General Electric.

2000s

The Open-Source Era

The rise of Linux (mascot, right) ushers in the "open-source" era. The mantra: Cooperation is good, even with rival organizations. More broadly, companies embrace collaboration with outsiders as a corporate strategy. The movement spells the demise of the "not invented here" attitude. Silos fall; partnerships reign.



Grudge Matc

Sirius

BIRTH NAME CD Radio, in 1990
HOME Pricey digs in NYC's Rockefeller Center
FAN BASE 4.7 million subscribers as of June 2006
BOASTS More than 125 digital music and talk channels; stars include **Howard Stern,** Jimmy Buffett, Martha Stewart
RANKING Share price down 44% in past year
NET LOSS IN 2005 $863 million

BIRTH NAME American Mobile Radio Corp., 1992
HOME A former printing plant in Washington, D.C.
FAN BASE 6.9 million subscribers as of June 2006
BOASTS More than 170 digital channels; stars include **Oprah Winfrey,** Opie & Anthony, and Bob Dylan
RANKING Share price down 66% in past year
NET LOSS IN 2005 $667 million

BY TOM LOWRY AND PAULA LEHMAN

THE MEDIA AND ENTERTAINMENT WORLD HAS LONG served up epic battles, whether it was the Hearst-Pulitzer newspaper wars, MGM vs. Warner Bros. Studios or, more recently, Fox News's assault on CNN. But the rivalry that has been blazing for six years between XM Satellite Radio and Sirius Satellite Radio sets new standards in the art of one-upmanship. What began with some space-age technology and deep-pocketed investors has escalated into a pageantry of excess. Hundreds of millions have been laid out for star-studded programming—Stern, Oprah, Martha, Dylan—but nary a penny of profit has been made.

Orchestrating this war are two CEOs with a whole lot to prove. XM's Hugh Panero, a cable industry vet, was passed over for a new top job at a pay-per-view company. Sirius CEO Mel Karmazin, an old radio hand, was forced out as the No. 2 at Viacom Inc. Each is fully aware that XM and Sirius may seem very similar. Dozens of channels each, half music, half talk. Same price. Flip a coin, right? That's why the two play such a pitched public-relations game. If these guys were on the hard court, their fevered volleys would make for a riveting match. So that's where we put them.

THE OPENING VOLLEY

» XM rolls out its serv ahead of Sirius in la and gets a huge advanta on from having more adv technology and by sealin lucrative deal with Gener Motors.

THE FIRST ACE

« Outbidding XM, Sir announces in Dece 2003, that it has reache 7-year, $220 million deal broadcast NFL games. Fi behind the baseline, XM grumbles that everybody in front of the TV for the games on Sunday aftern anyway.

…E: SIRIUS

…tober, 2004, Sirius … the entertainment …nouncing that … Howard Stern will … broadcast radio to …rius outbids XM … by agreeing to pay …n over five years.

…llows the Stern …uncement with its …al yet: an 11-year, …n pact to broadcast …ue Baseball games. …trump shock jocks, …nero.

…GE: SIRIUS

…ping to create huge …zz about Stern and …erings, Sirius hires …MG music group PR …netime *Wall Street* …porter Patrick Reilly, …meister.

…DEUCE

…than a year later, XM …Reilly's former No. 2 …athaniel Brown, to be …ister.

…OM THE STANDS

…feisty New York …ve expressing himself …ds is Stern's old boss …Broadcasting, Mel … Karmazin accepts a …s in November, …once said satellite … no future.

MEANWHILE, OFF IN THE VIP TENT…

In 2005, Sirius signs Jimmy Buffett; XM announces a partnership with Napster. Sirius announces a 24/7 Springsteen channel; XM says it will become exclusive broadcaster of the National Hockey League starting in 2007, taking over for Sirius. Sirius announces a new channel for Martha Stewart. XM creates one for Bob Dylan. In early 2006, XM signs Oprah.

ADVANTAGE: SIRIUS

In May of this year, XM lowers subscriber growth projections from 9 million to 8.5 million. Its shares drop some 11%. Sirius quickly puts out a release reaffirming its 2006 target of 6.2 million subscribers. In July, Karmazin projects positive cash flow for Sirius in late 2006.

GAME, SET, MATCH?

In June, Karmazin says he'd like it if Sirius bought XM but isn't sure regulators would approve such a deal. Panero's response: "It's wishful thinking." So, it seems, are profits: After XM reports a wider-than-expected second-quarter loss, speculation heats up that it's takeover bait. Once again, it cuts its 2006 subscriber growth estimate, to 7.7 million. Still, Sirius trails XM by 2.2 million subscribers and lost nearly $200 million more than its rival last year.

KIRSTEN ULVE

GROWTH PATH
GE won Zhu over with talk of career development

Management Grab

In fast-growing China, multinationals are scrambling to attract and retain smart, bilingual executives. Here's how GE does it

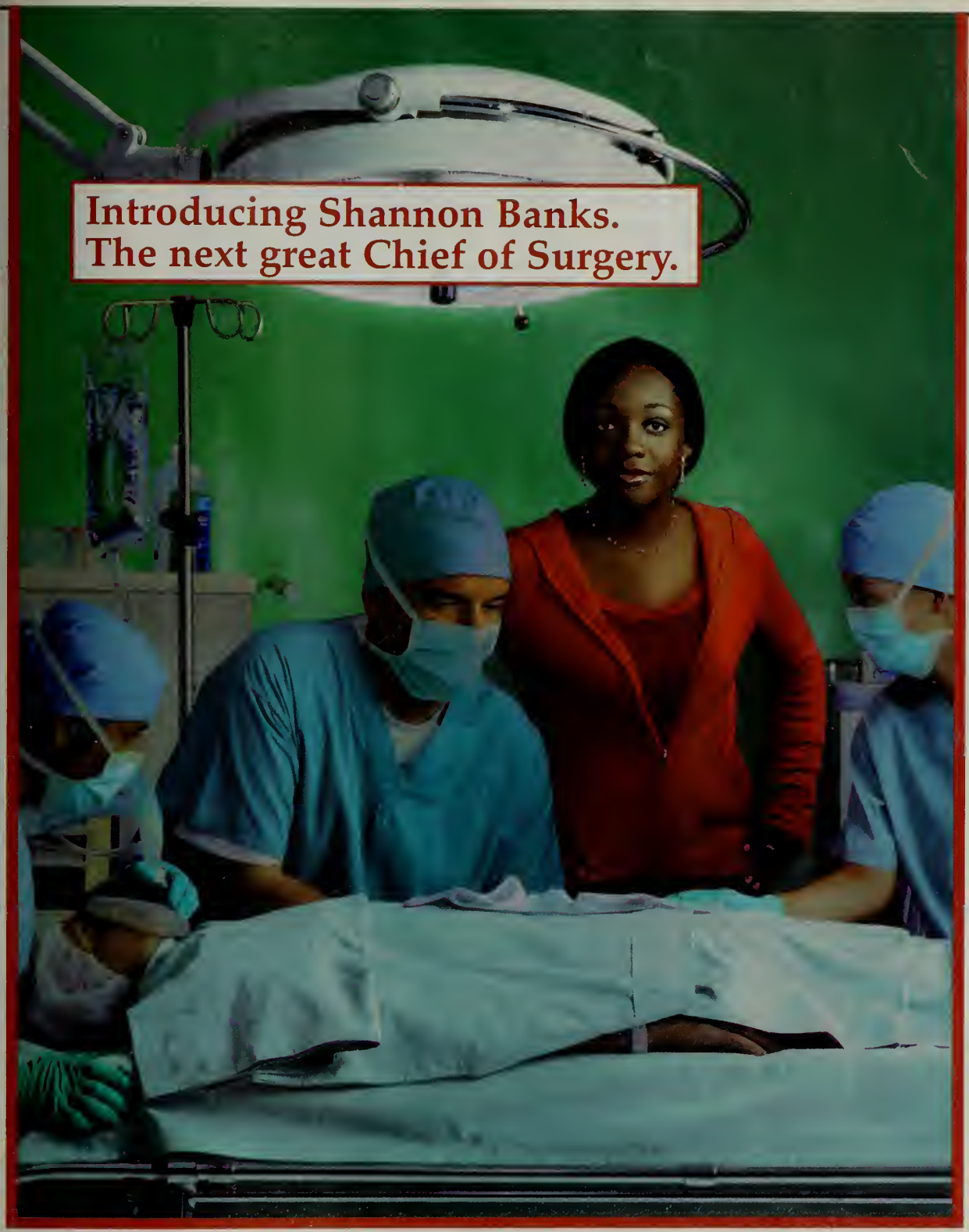
BY DIANE BRADY AND DEXTER ROBERTS

SOPHIA ZHU KNOWS ABOUT BEING wanted. When the Beijing native graduated from the People's University in Beijing six years ago, she was deluged with job offers from multinational companies. An economics and international trade major, Zhu could have picked from a number of Western-based outfits working in China. Instead, she chose General Electric Co. What won her over wasn't the pay (other companies offered more). She picked the employer that would help her rise fast in one of the most competitive and potentially lucrative economies in the world. "They talked about development opportunities and gave a very clear path to career growth," says Zhu, now 28. Surprisingly, perhaps, she's still there.

As companies scramble to establish a foothold in China they have encountered a daunting stumbling block: people. There just isn't enough top-tier local talent to fill the escalating need for professionals, technical experts, and managers in Chinese operations. A 2005 McKinsey & Co. stud estimates that Chinese companies will nee 75,000 business leaders who can work in glob markets over the next decade or so. As of late la year, there were 3,000 to 5,000 Chinese executive who fit that bill. Add to that a desire among man Chinese professionals to increase their paycheck and positions as fast as possible, and it's clear tha competition for talent will only intensify. In global survey of 4,500 leaders by consultancy De velopment Dimensions International, Chines executives emerged as particularly ambitiou "You see title inflation and raises of 50% to 60% year," says DDI Senior Vice-Presiden Richard S. Wellins.

6.8%
Voluntary turnover of GE executives in China; for all companies, it's 14%

China presents unique challenge for foreign employers. Along wit the usual barriers of language training, and cultural fit, China ha the added factor of the decade-lon Cultural Revolution, which brough the education system to a virtual hal and ended only in 1976. "A whol band of people who might now be con



As a pre-med student studying at one of America's Historically Black Colleges and Universities (HBCU), Shannon is poised to make great contributions to medicine. A commitment to developing future leaders is why Honda sponsors HBCU programs such as the Honda Campus All-Star Challenge and Honda Battle of the Bands. Because of the important work done by these great educational institutions, young people like Shannon will one day literally save lives.

HONDA
The Power of Dreams

For information about America's Historically Black Colleges and Universities visit hbcu-central.com or honda.com. © 2005 American Honda Motor Co., Inc.

XIE has risen at GE Aviation in Beijing; the people are what keep him there

sidered senior managers tragically had their education cut off," notes Joy Chen, who heads the Global China Talent Project for executive search giant Heidrick & Struggles International Inc. As well, there has been a talent drain to the West in recent years, and government-funded schools haven't focused on skills needed in a commercial enterprise.

When smart, bilingual Chinese nationals come along, they're often snapped up, quickly promoted, and, all too often, stolen away. GE Chairman Jeffrey R. Immelt estimates that executive turnover in China is at least twice the U.S. rate. "We're very diligent about opening up lots of doors for the best people," says Immelt, noting that foreign assignments help build loyalty.

That approach has certainly won over Zhu. She entered GE's financial management program, taking classes and working in spots like Japan. The company also gave her a mentor, leadership training, promotions, ev access to Imm through dinners a groups like the C Women's Network. No she's on an 18-mon assignment in Wauk sha, Wis., as part of t global planning a analysis team for C Healthcare. While hea hunters have called to o fer jobs, she doesn want to leave. "I kno I'll have a bigger ro when I go back to Chin and I see a great futu here," says Zhu.

Because the Chine market is so hot, she will probably nab the kind opportunity that a twentysomething employee the U.S. can only dream about. Heather Wan who heads up human resources for GE China, sa about 60% of the company's salaried employe are under the age of 35. And a position that tak five years to reach in the U.S. often takes only thre years to get in China.

In a booming job market, money clearly ma ters. GE managers often dispense goodies like " night on the town"—awards of, say, $100 to tak the family out after a job well done. Wang note that GE staffers are particularly vulnerable t poaching at the three-year point—after they' soaked up enough training and responsibility t be attractive to others but before they really ar loyal to GE. "These people want to be a CEO in few years," says Wang. Some don't like the cul ture, which emphasizes independence, multipl bosses, and team projects over a hierarchy wit one boss.

What distinguishes GE are the efforts to mak promising employees feel stimulated, recognize and nurtured. "GE's value proposition is the sys tem of things it can do for you," says University o Michigan professor Noel Tichy, who had a hand i developing that approach when he ran GE's Cro tonville (N.Y.) leadership center during Jac Welch's era. Under Immelt, GE has opened a larg research and training facility in Shanghai.

GE's China operations are filled with young peo ple, but the focus isn't limited to that generation Albert Xie, general manager for market develop ment at GE Aviation China in Beijing, joined GE i 1997 and, at 45, has risen through several posi tions. What keeps him there: the people. "Almos every day, we go out to lunch together, and if some one's not ready, we wait," he says. "Money's im portant, but people are equally important."

Immelt is happy to hear that, as long as teams perform. But "it's almost impossible to stop turnover from being higher than in the U.S.," he says. Mentors, trips, and fun money can't always beat a bigger job and paycheck. "At the end of the day, we have to make sure our pipeline is full."

HOW I COMPETE

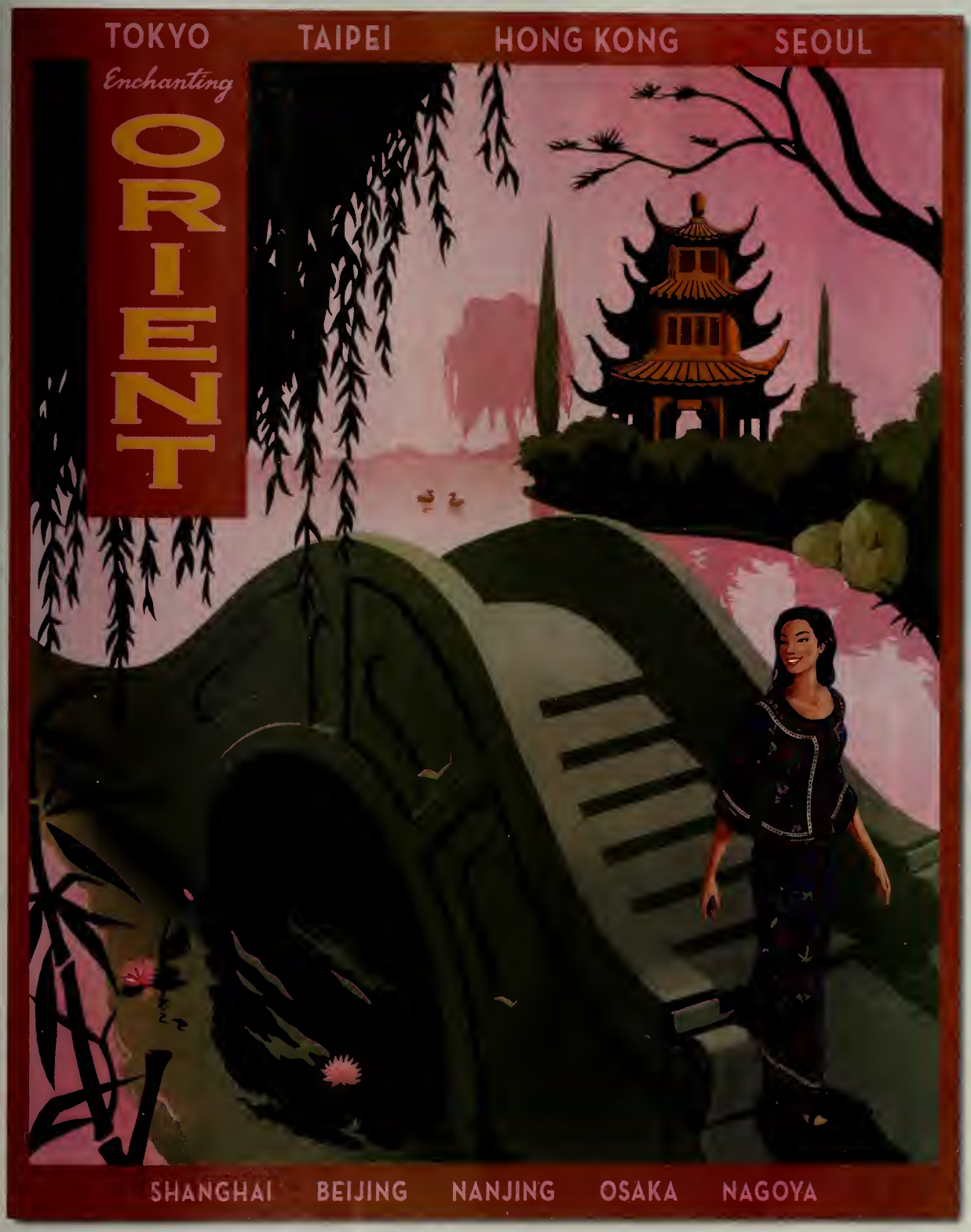
Stephen Schwarzman

The CEO of Wall Street's fast-growing empire, The Blackstone Group, demands perfection and encourages innovation.

The idea of exceeding your normal capabilities by just pushing beyond them is really a psychologically interesting endeavor. It creates a very alert, innovative way of thinking, whether it's in sports or business, always to find a better way to do something. A better way to hit the ball. A better place to put the ball. Hitting the ideal shot. Doing something in the perfect way.

[In business] you have to make sure that people share the same values. People have to understand that the game really is to compete and win. It's not just to do the work. In finance, you have to let people know that anything you do has to have a zero-defect culture—where every number has to be right, every piece of written work has to be perfect, and that's a baseline that everybody on the team has to know. Then, you need flexibility so that you listen to anyone on the team. That's key because sometimes the newest or youngest person on the team can have an insight that is absolutely terrific.

[Wall Street] is a business where there's a lot of adaptability. New products can be invented all the time, and the newest tend to have the biggest profit margins. So there's a premium on innovating. That attracts competitive people.



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A STAR ALLIANCE MEMBER

A Passion for the Pla

Patagonia aims to produce top-quality products while doing the least possible harm to the environment. It's a mission that attracts and holds top-notch talent.

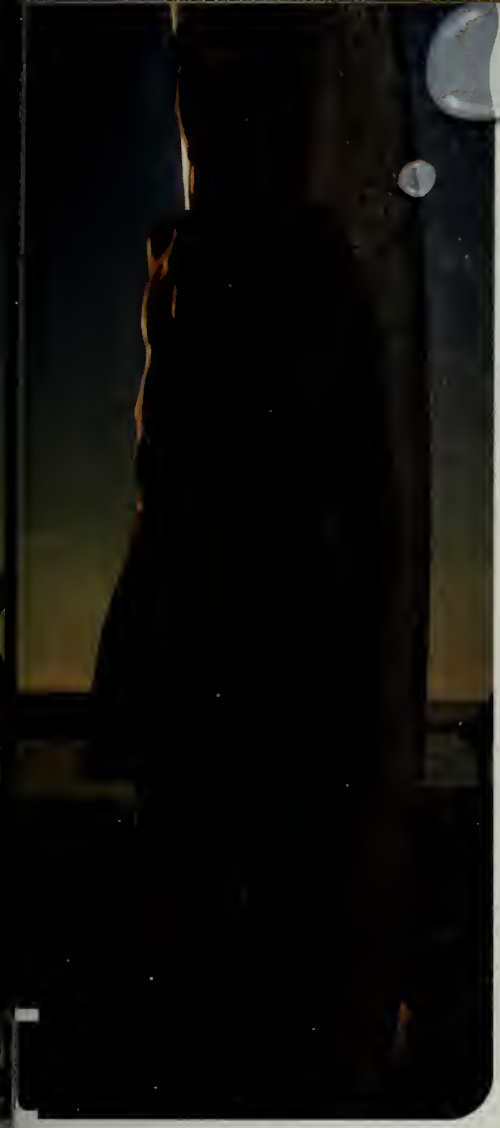
BY STEVE HAMM

SOUTHERN CALIFORNIAN SCOTT ROBINson had quite a résumé when he returned from studying in France last Christmas. The 26-year-old had an undergraduate degree from Bucknell University, two MBAs, and internships at two of Europe's most respected corporations, Nestlé and Unilever Group. Yet, when it came time to take the next career step, he chose a job as a stock handler in a surf shop in Cardiff-by-the-Sea, Calif. Actually, he begged for the job. What gives? Simple, he says: "I wanted to work for a company that's driven by values."

The company is Patagonia Inc., a Ventura (Calif.) seller of outdoor clothing and equipment that has a reputation as an enlightened employer and champion of the environment. On his return from France, Robinson read *Let My People Go Surfing*, a memoir and manifesto of sustainable business practices by Patagonia founder and Chairman Yvon Chouinard. The company's goal as simple as it is challenging: to produce the hig est-quality products while doing the least possil harm to the environment.

That mission is a daily inspiration for Patag nia's 1,275 employees, from Chouinard to the fl flop-wearing guy who answers the phone in t headquarters lobby. Most corporate mission sta ments are empty platitudes. This one guides eve decision. And it's the centerpiece of a set of ma agement practices that have helped Patagonia gr at a healthy rate and retain what is arguably t best reputation in its industry even while it faces i creasing competition from much larger compani

Patagonia's philosophy is the handiwork Chouinard, a gruff yet funny outdoorsman wh despite his 67 years and arthritic hands, has slowed down much. He helped pioneer mode rock-climbing techniques in his youth and nc prowls the globe in search of outdoor adventur



product ideas. That is, when he's not shaking his 33-year-old company, helping to preserve environment, or advocating radical changes in way Americans do business. "Most people nt to do good things, but don't. At Patagonia, it's essential part of your life," says Chouinard.

t a time when companies must adapt to an r-quickening competitive pace, a highly motied workforce can provide a crucial edge. Until v, there have been two primary approaches to ping employees at the top of their game. At the h-stress workplace, bosses rule by fear, cking ass and taking names. At feld places, managers try to motivate ployees with kind words and erous benefits. Neither apach is optimal. In a recent lup Poll, only one-third of ericans considered themselves sionate about their jobs.

Only 33% of Americans say they're passionate about their jobs

A few companies have found a bet- way. "There are companies that ss continuous improvement and being y better than the competition but also make ple feel comfortable," says Stanford University fessor Jeffrey Pfeffer. These companies range m publicly traded giants such as FedEx and thwest Airlines to small fry like Patagonia. They are meritocracies with ambitious goals that trust their employees to do the right thing—and give them the tools and time they need to do it.

Patagonia, with 39 stores in seven countries, works hard at achieving that delicate balance. It offers an on-site day-care center at its headquarters and full medical benefits to all employees, including part-timers. When the surf's up, Chouinard himself urges people to hit the beach. At the same time, the company demands hard work, creativity, collaboration, and results. Management isn't shy about axing employees who aren't up to snuff.

SURF'S UP Cardiff-by-the-Sea store manager Devon Howard hits the beach with his staff

Reluctant Businessman

PATAGONIA ENJOYS AN UNRIVALED reputation among outdoor aficionados, and its green philosophy is gaining broader appeal as more Americans embrace sustainable consumption. Chouinard's goal for Patagonia's own sustainability: "I look at this company as an experiment to see if we can run it so it's here 100 years from now and always makes the best-quality stuff," he says. That means keeping growth relatively slow but steady, at about 5% per year. Revenues were up a healthy 7% last year, to $260 million. Operating margins typically come in at the high end of the 12% to 15% industry average, according to people who have seen the numbers, and that's after it donates 1% of revenues to environmental groups. Patagonia, which declined to comment on its financials, is owned by a Chouinard family trust.

Chouinard calls himself a reluctant businessman. He disdains cell phones and laptops as much as he does quarterly-earnings-obsessed executives. (As you might imagine, he's as likely to take the company public as he is to club baby seals.) Yet he finds that concern for quality and sustainability doesn't pose a conflict with running a highly successful business. "Every time we do the right thing, our profits go up," he says.

Odd as it may sound, Chouinard gets a lot of business done standing waist-deep in water. He has coined a term—MBA, or managing by absence—that sums up his leadership philosophy. At the office, he's totally plugged in. But he spends much of his time traveling around the world doing outdoor things and talking to outdoor people about their likes and dislikes. Sometimes the best way for new CEO Casey Sheahan to get face time with Chouinard is to meet him on the water. Last year, the two were fishing for steelhead in British Columbia when they noticed that their feet were cold. Clearly their Patagonia waders weren't up to the job. They decided to launch a series of quality meetings to review and improve the company's products.

Chouinard and Sheahan are hardly the only Patagonia employees to enjoy "Eureka!" moments in the great outdoors. Getting away from the office regularly is a job requirement—considered essential for dreaming up the next genera-

CHOUINARD In search of outdoor adventures and product ideas

tion of products. Whenever employees play outdoors, they're testing the newest gear or coming up with improvements. Regularly, teams of 20 to 30 people, including outdoor professionals Patagonia calls its ambassadors, go on excursions where they climb, fish, ski, or surf.

During such an outing at Yosemite National Park two years ago, mountaineer Dean Potter snipped the legs off of a pair of climbing pants at mid-calf so he could see his feet as he climbed. The next year, Patagonia offered a successful line of pants based on his ideas. "We spend a lot of the time climbing and cooking and drinking excessively," says designer Carey Mullett. "It's hard for people who are used to a fixed itinerary to understand, but it's this kind of deconstruction that leads to the most creative work."

Patagonians like to say they don't have a corporate culture, they have an unconventional culture. That goes not just for product innovations but for new business ventures. You can see the effect of this philosophy in the company's major new strategic initiative, surf shops. It signed up three professional surfer brothers, Chris, Keith, and Dan Malloy, who had sponsorship contracts with larger surf outfitters, to help come up with a vision of what Patagonia surfing should be.

The Malloys, with their deep tans and unr sun-bleached hair, are far from the usual corpor stiffs. Chris, 34, explains how they bonded w Chouinard, a crack surfer himself, during a trip Chile in 2004. They discovered they shared c cerns about water pollution and wastefuln (Chouinard, Chris notes, wore the same shc eight days straight. Now that's conservation!)

Green Sabbaticals

ULTIMATELY, GIVEN THE FREEDOM to try son thing different, the Malloys and Patagoni strategists came up with a new concept for a s store. Rather than copying rivals and selling lo clothing and boards that break easily, it s durable boards and wet suits, and simple, lor lasting clothing. The focus is on "authenticity" a building a solid community—one that will, th hope, give their shops a sustainable edge. Ev store will have a space set aside for surfers and e vironmental groups to gather.

The strategy is off to a strong start. Sales at t first store, opened in June in Cardiff-by-the-S have been running 50% higher then expected, sa Chouinard. The Malloys are now scouting lo tions in Ventura and Santa Cruz, Calif., and Hawaii. Patagonia plans on operating 10 st stores within the next several years. "We took sor big pay cuts to work for Patagonia, but we're r regretting it," says Keith Malloy, 31.

Few Patagonians are in it just for the mon The company recently raised salaries to adjust the cost of living, and everybody gets an annu bonus based on profits, but, overall, Patagonia pa at, or just slightly above, the market rate. Howev the most significant rewards aren't monetary. O popular perk is a program that allows employe to take off up to two months at full pay and wo for environmental groups. Lisa Myers, who wor on the company's giving programs, tracked wolv in Yellowstone National Park during her sabba cal. The company also pays 50% of her college e penses as she pursues a wildlife biology degr "It's easy to go to work when you get paid to what you love to do," she says.

Patagonia's culture makes it a magnet for t ented people. The company receives an average 900 résumés for every job opening, so it can affo to be picky. Top outdoor industry executives wa to work there, too. Sheahan just lured Dami Huang from much larger rival North Face to r Patagonia's product development group.

Can others capture some of Patagonia's magi Most companies—especially ones with demandi public shareholders—simply can't let employe take a surfing break. They can, however, foster cr ativity and provide a sense of purpose. Perhaps th most valuable and easily applied lesson from Pata onia's experience is this: To think outside the bo sometimes you need to get out of the cubicle. ■

HOW I COMPETE

Hasso Plattner

Before stepping down as SAP CEO in 2003, Plattner carried on a famous rivalry with Oracle CEO Larry Ellison on the high seas via racing yacht

As a motivator in a company you have to overemphasize a bit, without promoting the fear factor—although you need a little fear factor. You need a little paranoia. You have to try to make people understand what you see as the leader of the company. It's like a captain on a ship, you have to anticipate the weather. This is what's most likely to happen, and let's do something about it.

It's always a time of celebration when you see your competition make major failures. But you have to understand it's only a short window of opportunity where you can take advantage of their failures. They will correct and come back stronger.

There are a lot of similarities [between sailing and business]. Dedication to win. Hard work. I have gone back now in my old age to sail two-man dinghies, 505s, and I [recently] participated in the world championships at Hayling Island in England. In order to compete, I had to practice. The last 12 months I practiced 100 days. You could say this is completely stupid. But if you want to do it, you have to do it. You can't say "I'm a good sailor." The young guys will sail circles around you. You have to prepare physically, technically, and mentally. In this respect, it's very similar to business.

Big-boat sailing is a little bit too elitist; there is too much money involved to appeal to everybody. The major thing is you have to be dedicated and throw yourself in and work hard. There is no such thing as luck. You might be lucky once, but not more than once.

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intel hp invent

Sleeping with the Enemy

More companies are finding that "co-opetition," or learning to work with rivals on certain projects, may be the best strategy

BY PETER COY

THERE'S ONE SHAI AGASSI WHO HARBORS violent visions of defeating Microsoft Corp. "We're both going in with swords drawn, and we're going to do battle until we win. And there's not going to be any other result. We'll do everything possible to draw blood," vows this Agassi, the top technology strategist of German software titan SAP.

Another Shai Agassi considers Microsoft his company's closest partner. This kinder and gentler Agassi fancifully traded bags of green M&M's last year with his Microsoft counterpart, Jeff Raikes, to seal a deal to jointly develop a piece of software called Duet.

Both these Shai Agassis are two sides of the same person: a U.S.-based member of SAP's executive board who oversees the complex relationship with Microsoft. "This is the beauty of being human," he says. "You can ha two conflicting thoughts at the same time and go crazy."

Finding the right formula for this kind of "opetition" has never been more important. Ma new products, from video to financial services, c be provided only in complex packages of har ware, software, and services. By working togeth such as agreeing on the Wi-Fi standard for hig speed wireless, competitors can expand the ma ket so everyone wins. "The traditio model says you have a fixed-size pie a you kill each other for a slice of i says Navi Radjou, a vice-president Forrester Research Inc. in Ca bridge, Mass. "This new visi calls for collaboration to increa the size of the pie."

Putting aside narrow self-inter for the common good sounds eas than it is. Most companies hate to yie

98%
of SAP customers also use Microsoft Office

illimeter to arch-
s. Witness the war
a standard for
-definition DVDs
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iba Corp. and
Corp. Neither
will back down.
omers are hesitat-
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ing the standard
becomes obsolete.
yone loses.
ne trick to getting
s done is to remember the real objective, which
gger sales and profits. That's what SAP and Mi-
oft did. The companies vie for sales to midsize
nesses, but elsewhere they're natural partners,
e each dominates a different part of the soft-
world. Duet, their jointly developed product,
vs a Microsoft spreadsheet to pull in data from
AP accounting program. Agassi said he had to
age concerns of SAP's reps that working be-
Microsoft's user interface would undercut
s sales efforts. Says Agassi: "The customer base
ts us to stay gentlemen, so that's what we do.
keep the competition inside a fence and don't
ne blood leak out."

for Tat

MPLE BUT EFFECTIVE strategy for cooperat-
with a rival was worked out by University of
higan political scientist Robert Axelrod. In a
puter experiment, he found that the best ap-
ch is tit for tat. Start by cooperating. After that,
the other person. If he keeps cooperating, you
oo. If he defects, retaliate. To stave off a break-
n of trust, be somewhat forgiving of mistakes
ne other side. Axelrod showed that by following
e rules, even if the other person doesn't initial-
operate, you will guide the relationship toward
sistent cooperation with a minimum of cheat-
According to Axelrod, the strategy has been
l by "nations, bats, birds, and monkeys."
f course, fraternizing with the enemy is a fire-
offense if it's initiated by anyone outside the
uite. That's why the top boss has to be 100% be-
l the arrangement. Engineers tend to adapt
kly and view the deal as just another technical
blem to solve, but salespeople are often harder
ring around. Microsoft's Raikes says that when
deal with SAP was announced, "the salesforce
l: 'How can that be? You're now partners with
mpany that we compete with. Does that mean
re going to back away?'" His response was that
rosoft had no intention of going easy on SAP.
ople have had a hard time parsing that," Raikes
s. "[CEO] Steve Ballmer and I had to step up at
sales meeting last year and take them through
idea." Red Hat CEO Matthew J. Szulik had sim-
difficulties this summer explaining to interns
his Linux software company considered IBM
rtner, even though IBM sells competing soft-

PLAYBOOK: BEST-PRACTICE IDEAS

A Delicate Balance

Cooperating with rivals can be tricky. A few rules of the road:

IMPRESS CUSTOMERS by working with others on their behalf. But clearly separate the cooperative part of the relationship from the competitive one.

EXPAND THE PIE, because a bigger market can make everyone a winner. Expect skepticism until the troops understand the partnership.

MAKE A COMMITMENT, but remember that situations change—you're dating, not married.

REWARD YOUR SOMETIME RIVAL for acts of trust, but be sure to punish cheating swiftly.

ware and partners with Red Hat rival Novell Inc. "It was an hour discussion," he says with a sigh.

Get ready to have plenty of those conversations. The power of co-opetition will only grow as products become more complex and as competition widens globally. Says SAP CEO Henning Kagermann: "Our larger customers don't tolerate vendors acting like children and fighting among themselves. There's a point where you step back from being too competitive." In other words, it's not just about bashing the other guy. "This is a different type of competition," he adds. "You focus on what you can do for the customer."

HOW I COMPETE

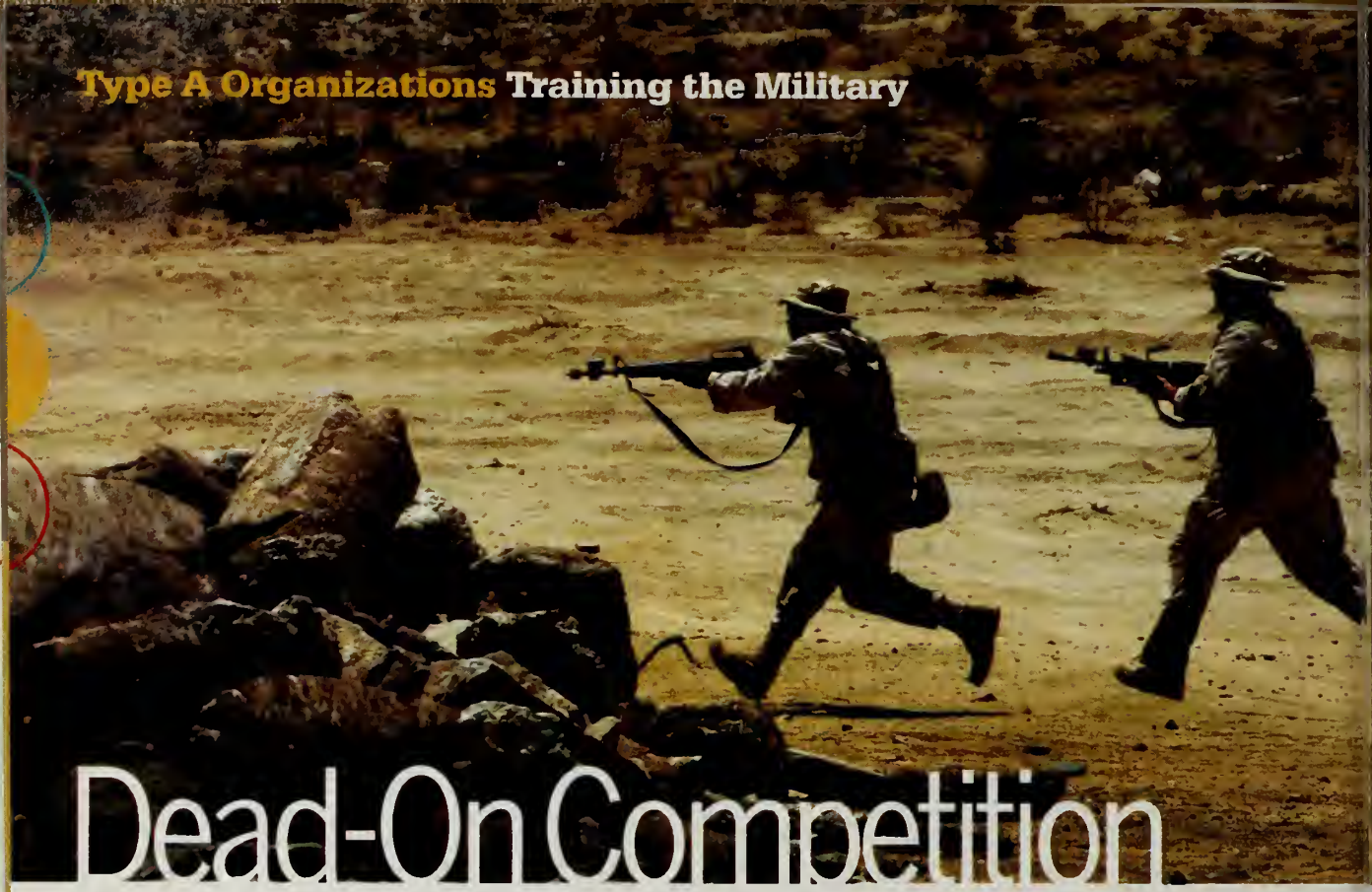
Jamie Lee Curtis

The film star is also a children's book author. Her new book Is There Really a Human Race? *teaches kids about competition.*

I believe in healthy competition. I have basically taken every job that has come my way. I have not sat back and mulled over choices. Early on I was a regular on a TV series, *Operation Petticoat*. I was making more money than I thought I'd ever see—$780 a week. To a 19-year-old girl whose rent was $300 a month, that was crazy money. I got a little cocky. I did not know my lines. I was pulled aside by a producer who said: 'Do you like your job? Because if you do that again, you may not have it.' That was all I needed, that little adjustment.

We live in a society where images of those big Styrofoam fingers saying, 'We're No. 1,' are the big picture for kids. They see it in every element of society. My little boy, who's 10, knew what the No. 1 movie of the weekend was. It didn't matter if it was a good movie. When he was 7, he came home one day and asked: 'Is there really a human race?' The subtext was: 'Am I in it, and why didn't you tell me?' It was as if he walked by a mirror and saw he had a number pinned to his back.

I thought he was asking a universal question that crosses all ages and genders. It's this seemingly unending race for the big Styrofoam finger. So I wrote: 'Sometimes it's better not to go fast. There are beautiful sights to be seen when you're last. Shouldn't it be, looking back at the end, that you judge your own race by the help that you lend?' That's the best writing I'll ever do.



Dead-On Competition

The U.S. Army prepares soldiers stateside with frighteningly lifelike war games for the guerrilla attacks they will encounter on their tours of duty in Iraq

BY CHRISTOPHER PALMERI

ALPHA COMPANY SEEMED TO BE DOING everything right. After a soldier in a nearby unit got wounded by a mortar attack, the platoon entered the city of Medina Jabal in textbook fashion. The soldiers went to the chief of police and asked him to accompany them on a search for the insurgents. Working through a translator, they respectfully interviewed the locals. After spying two villagers trying to hide a rifle, the soldiers gave chase in the 110F heat. They captured the men and brought them in for questioning. Soon after, things took a deadly turn.

An improvised explosive device (IED) hidden in the street exploded, killing two Alpha Company soldiers and three of their Iraqi Army colleagues. The Americans quickly established a security perimeter and called for a truck to evacuate bodies. But before it arrived a car bomb went off, killing two more U.S. soldiers. "They failed to put a distance between them and the IED," said Sergeant First Class John Placentia, noting that insurgents often set off several explosions in a row to kill people who respond to the first one. "This platoon is now combat-ineffective. The enemy was successful." Fortunately for all involved, it was only a training exercise.

If war is the ultimate competition—a life-or-death struggle on a bloody proving ground—then Fort Irwin, Calif., is the last scrimmage before big game. The U.S. Army National Training Cen is located 150 miles northeast of Los Angeles o 1,000-square-mile stretch of desert next to De Valley. Roughly 50,000 soldiers a year are through the facility. Each month a new, incomi Blue Team faces off against battled-hardened R Team trainers. The fighting isn't real, but stakes are high. Most of the Blue Team soldiers v be deployed to Iraq within months of their vi And as they like to say in the Army: "You fight you train."

Avoiding Fatal Mistakes

AS IMPORTANT AS IT IS to the Army, Fort Irw also provides a lesson for any institution trying cope with change in a volatile environment. message: Create your own competition, t yourself, and find your weak spots before rivals it for you. In the late 1990s, Jack Welch had a p gram at General Electric Co. called "Destroy Yo Business," where division heads dispatch teams of mock rivals to attack business units. no longer engages in the exercise, but there some who think every business should. "This required to get folks' heads in the right plac says Robert E. Mittelstaedt Jr., dean of Arizo State University's business school and author

Will Your Next Mistake Be Fatal? Avoiding the Chain of Mistakes that Can Destroy Your Organization. "It brings out very different ways of thinking and helps [you] realize where you are vulnerable and where you may not be," he says.

Fort Irwin first opened as a training ground for Cold War-era tank battles in 1981. As the insurgency heated up in Iraq, the Army shifted its focus to guerrilla war. The Red Team consists of 1,600 U.S. soldiers and civilians who live for three-week stretches in 12 villages designed to look like Iraqi communities. About 250 team members are Iraqi-Americans such as Sam Kalasho, a 50-year-old liquor store owner from San Diego. Like most members of the Red Team, he's happy to play the heavy if it's for a greater good. "I see what we are doing making a big difference," he says. "It could save the life of a soldier or civilian in Iraq."

The Army spends an extraordinary amount of money and time on authenticity. The Red Team cooks real Iraqi meals in the villages. Loudspeakers on mosques call them to prayer five times a day. ere's a soccer league in which villages compete inst each other. And as in the real Iraq, there U.S. contractors. L3 Communications Corp. su- vises the Arabic-speaking civilians. Raytheon provides the vehicles used by insurgents.

The preparation begins some six months before nit is due at the fort. The commander of the gade to be tested gives trainers an assessment of unit's strengths and weaknesses. About 200 ners known as Lizards devise elaborate scenar-. Villagers get fictitious jobs, ilies, and religious affilia- ns. Story lines are written, es set, and attacks planned wn to which Red Team mem- s serve as financiers, bomb- kers, and trigger men.

The Blue Team arrives at Fort in much as it will in Iraq. A ging area serves as a sort of ni-Kuwait, where reconnais- ice units assess the terrain in- e the "box." Then it's out to field, where the Blue Team

WAR GAMES New Blue Team arrivals at Fort Irwin in the desert of California

REALITY CHECK A Blue Team unit frisks some seasoned Red Team soldiers posing as insurgents, who keep a hidden weapons stash

"WHAT COULD PERSUADE A MAN WITH INTERNATIONAL RESPONSIBILITY FOR ONE OF THE WORLD'S BIGGEST COMPANIES TO ADMIT TO A MAJOR ATTRACTION FOR FRANCE?"

Nani Beccalli explains why GE can't do without French high-tech.

see next page

builds bases surrounded by concertina wire, seven-foot-high berms, machine gun nests, and serpentine access roads. Overhead, reconnaissance drones keep watch on enemy movements. Convoys, constant targets themselves, supply the bases.

Soldiers fire blanks, of course. Team members wear harnesses with sensors that register when they've been hit, a sort of heavy-duty version of laser tag. When an explosive device goes off, an impartial observer with a "God gun" eyeballs the radius of the explosion and zaps those impacted.

50,000
Number of soldiers who go through Fort Irwin per year

"Like Nothing Happened"

A BIG PART OF the training process involves punishing the Blue Team for mistakes. When members of the 2nd Brigade Combat Team, 2nd Infantry Div. came to cordon off the mock village of Medina Wasl at the exact same time they had the previous night, an insurgent was able to slip out with a mortar just minutes before their arrival. The insurgent, played by Staff Sergeant Melvin Thomas, spent the whole night out in the field. He attacked a Blue Team base at 10 p.m., hid, and then slipped back into his village at 5 a.m. With a sr on his face, he happily recounted mayhem inflicted—10 vehi damaged, one destroyed, 10 diers hurt.

Thomas, a 26-year-old from D ton, is, like most members of the Team, an Iraq War veteran. He fered through seven IED attacks with serious injury. "I never saw the enemy," said. "They'd come out at night and plant bom They'd run in a house where there would women, children, other men. They'd change clot and walk around like nothing happened."

Trainers at Fort Irwin put stress on soldi every chance they get. During a search of Ir homes, Golf Company found a man with a r Brought outside in handcuffs, the man pleadec be given over to the Iraqi Police standing near "I.P., I.P.," he said as a crowd of villagers gathe in the stifling heat. A translator said the man o used the rifle for hunting, but after radioing his periors, Specialist Drake Hill informed the pol that the man would be taken back to a Blue Te base for questioning. That was the right decisi "If you go to the gym and just do what you can you don't improve," explains Lieutenant Colo James Miller, deputy commander of operations Fort Irwin. "This is mental muscle building."

The Blue Team follows each mission with wh the Army calls an After-Action Review. Many them take place with maps on the hood o Humvee. The reviews are freewheeling affa where every soldier is encouraged to speak up a give an assessment of what went wrong and wh could be done better.

The trainers try to stay one step ahead, often corporating real experiences from the front lin As sectarian violence has increased in Iraq, so h the presence of mock death squads and assassi tions at Fort Irwin. Soldiers who stray from th unit are theoretically kidnapped and execut Capturing the hearts and minds of the Iraqi what the Army calls "nonkinetic" operations—h become a top priority.

There are two fake TV networks operating at t training center, one resembling CNN, the other Jazeera. On Day 11 of a recent tour, the Blue Tean Major Chris Wendland was monitoring lo broadcasts when he saw an interview with t mayor of Medina Wasl. The mayor complain about how soldiers were treating villagers. Th one of Wendland's officers appeared on screen sa ing that he and the mayor had a great relationsh The Americans seemed out of touch.

Sensing a public-relations disaster, Wendlan team discussed what to do. He dispatched the of cer, Captain Steve Poe, to meet with the mayor. A ter a two-hour negotiation that involved repar tions for a villager shot at a roadblock, Poe and t mayor posed for a photo, which was immediate distributed to the news media. "This is impo tant," Wendland said later at base camp. "This the fight we're fighting."

HOW I COMPETE

William Lerach

The Wall Street lawyer has forced hundreds of companies to shell out billions of dollars to settle securities-fraud lawsuits—and has earned plenty.

I'm driven, determined, and insecure. That's what makes somebody competitive. They want to succeed, but they're afraid they won't. Working seven days a week, being aggressive, how you go and get clients, how you sell yourself—to me competitiveness is just energy. Don't you think that all successful, hard-driving people are, at some level, insecure?

I have always felt that when you do the kind of work I do, it's to your advantage to keep your adversaries off balance. And a little bit uncertain and confused. Shakespeare said all the world's a stage. Remember that. I had a session the other day where I almost lost my voice because I was yelling so hard and harsh. I couldn't believe what these people were doing. You can't have just one mode of behavior or conduct, you have to behave as the situation calls for.

There's a time for yelling. But you can be empathetic. You don't need to hold people's heads underwater until they're going to drown. If you think your adversaries are behaving responsibly, maybe the way to help get the problem solved is to guide them in the right direction with a little bit of empathy. But there are other times when people need to get the s--- kicked out of them. Competition is a bit like foul-tasting medicine, but it's good for you. It makes you improve your product. I love and believe in what I do. I never said I was an angel.

Nani Beccalli, President & CEO, GE International says France has a talent for innovation.

"The French have a passion for engineering and technology, for research and solutions that push back the boundaries."

GE is as American as apple pie. What's it like doing business with the French?

GE today is a truly global company with a long history in Europe. There is a way of doing business which France and the United States have in common. Look at our 50/50 joint venture with SNECMA producing jet engines in France [CFM International]. It's an outstanding and extremely successful partnership. It has existed for 30 years and will probably be around for 30 more.

What qualities does France have to offer?

The French have a passion for engineering and technology, for research and solutions that push back the boundaries. The Ecole Polytechnique is one of the best engineering schools in the world and French technology tends to be very sophisticated. I'm a car fanatic, and I can still remember when the Citroën DS was introduced in the mid 50s. It was incredibly advanced, way ahead of its time.

Has France kept that edge?

A lot of European countries have either limited or even non-existent portfolios of technology products. France is different. They still have a pharmaceutical industry, aviation, space, a helicopter industry, a train industry...

GE in France

- Established in France for more than 50 years
- 9,500 employees, 3 R&D centers, 6 production sites
- GE's partnership with SNECMA gave them a lead in the aircraft engines industry

Does that make it attractive for a foreign investor?

Yes, especially if you're trying to make a technological product. In France, GE has one of the world's most technologically advanced units for producing turbines as well as the technology center for our medical business. The French are very creative. They have a great capacity for dreaming and they're not afraid to launch large-scale projects. TGV is a perfect example.

The French also value tradition. Does that make them conservative?

Respect for tradition doesn't mean you're afraid of change. I've brought my fair share of change to GE, but I have tremendous respect for tradition. You can tell by the way I dress. I'd say France strikes the right balance between tradition and innovation.

GE is a major player in financial services. How do you rate France in that department?

France is an advanced and sophisticated country where it's natural for financial services to be thriving. It has 60 million consumers. That's a rich community of people that has to save money, spend money, buy houses, buy cars, take out mortgages and borrow.

Would you live there?

Absolutely. Paris is my favorite city. I'm Italian, but I prefer Paris to Rome by a factor of 100. Paris is a place which combines tradition with modernity.

Now is the time to invest in France. To find out how the Invest in France Agency has helped some of the world's leading companies and what it can do for you, visit www.thenewfrance.com

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THE NEW FRANCE. WHERE THE SMART MONEY GOES.

Game Plan: First Find the Leaders

Maryland Terps' coach Sasho Cirovski changed how he picks captains—and it led to better teams

BY JENA McGREGOR

AFTER INSPIRING A BOTTOM-RANKED team to make six straight NCAA tournament showings, you can't blame Sasho Cirovski for thinking he was on the brink of a national championship. Instead, the 43-year-old head coach of the University of Maryland men's soccer team found himself watching his squad stumble back into decline. In 1999, several prized players were recruited by professional teams, damaging morale and performance. Cliques formed, eroding team chemistry. The next year, a rash of injuries plagued the Terrapins, or "Terps," as they're known to Maryland fans.

As a result, in 2000, the Terps failed to make the tournament at all. They lost all but one of their Atlantic Coast Conference games, ending the season second to last in the ACC. The next year, a wrenching loss to local archrival Loyola College in Maryland, the first in nine years, came shortly after September 11. By midseason, the Terps' record was middling.

Most troubling was the lack of leadership on the field. Although he'd selected his two strongest players as co-captains, Cirovski worried that they relied on him too much and weren't guiding the team out of on-field jams. Without a captain who had team respect on and off the field he knew he couldn't compete at a championship level. "I was recruiting talent," he says. "I wasn't doing a very good job of recruiting leaders."

Cirovski's complaint will sound familiar to managers frustrated with finding the right leaders. Many have a deep roster of talent but struggle to identify who has the critical support of the team. The problem is crucial in soccer, which has no timeouts and relies on dynamics on the field more than coaching from the sidelines.

Flummoxed, Cirovski called his brother, Vancho, then a human resources vice-president for Cardinal Health Inc. in Windsor, Ont. He thought Sasho should have his team take "X-ray." Not the radiological sort, of course. The ray Vancho had in mind was a survey similar one he'd used for organizational development asked questions such as "Whom do you rely up when your team needs unity and motivation?" a "From whom do you seek inputs and opinions fore making minor personal decisions?"

The results, Vancho said, would identify off-t radar leaders. Also called social network analy such surveys, the results of which are plotted a web of interconnecting nodes and lines represe ing people and relationships, are increasingly po ular among corporate managers who want to vi alize their informal organizational charts.

Cirovski decided to give it a try. He didn't w to just depend on his gut, and he was curious, t Armed with an MBA—Cirovski once thought h like to manage a soccer league—he had long be a fan of bringing business theories to the fie combing the works of gurus such as Tom Peter

The next day, after the players had taken t survey, Vancho called with the results. "How co Scotty Buete is not your captain?" he asked. "H off the charts. He's such a big influence." Cirov was shocked. Buete was a quiet sophomore

MOD SQUAD Cirovski, in black, uses social network analysis to single out leaders

mising local rather than a sought-after recruit. his was the same kid I had to... convince he was od enough to play at Maryland," he recalls. The results convinced Cirovski to move quickly. t hours before a midseason road game, he made ete the team's third co-captain. "Everyone is king to you to lead," Cirovski told him.

The team rallied around Buete, who went on to re the winning goal in that game and re- ined an effective leader until he graduated. here was this incredible sigh of relief—sort of e, 'He gets it,'" says Cirovski. "Scotty was the glue, and I didn't see it." Cirovski calls the change a defining moment that helped propel his team to four straight College Cup appearances (soccer's version of the Final Four) and, last year, the national championship.

Cirovski concedes it was no silver bullet, but the survey had a domino effect that prompted winning changes. The results hinted at two other emerging leaders whom Cirovski hadn't yet recognized but who would go on to become influential captains. In an indirect way, it helped attract one of Maryland's best-ever players, Jason Garey. "When I [visited], I saw Scott was captain, but he wasn't the best player," says Garey, who led the nation in scoring last year but wasn't a celebrated recruit when he joined. "That encouraged me."

The Chemistry of Victory

MORE BROADLY, THE ANALYSIS led Cirovski to renew his focus on building bonds between players. After having relaxed rules about their living arrangements, Cirovski brought players back on campus, requiring that teammates live together in dorms. He even coordinated room assignments to help develop certain relationships. And to get the best personality fits for the team, he shifted recruiting tactics, wading further down the list of star athletes.

Cirovski was so attuned to the ties between players that, not wanting to disturb the chemistry of the team that had made it back to the NCAA tourney in 2001, he did no recruiting in 2002 for the next season. "That is very unusual," says Jerry Yeagley, a veteran soccer coach. "You've got to really believe in yourself not to have a recruiting class."

Winning a national championship has fueled Cirovski's competitive zeal. ("It's like what I said when my first daughter was born," he says: "She's beautiful! I want another!") After losing six top-ranked seniors last year, he plans to hand out the survey three times this season.

This year's results have already helped Cirovski confirm his picks for captain and identify new players who are still turning to former coaches for support. They have also pointed to a looming shortage of leaders. But with plans to repeat the survey every year and a restored belief in the power of team bonds, Cirovski should be well prepared to find them.

PLAYBOOK: BEST-PRACTICE IDEAS

Building a Better Team

FIND YOUR UNDISCOVERED LEADERS

Sometimes the best leaders aren't the best players. Using social network analysis can help find unsung leaders who have the respect of the team.

BOLSTER TEAM BONDS

Many coaches, and managers, focus on relationships between themselves and their players. For Cirovski, it's the links between teammates that matter most.

FLAG EMERGING LEADERS

The "relationship survey," as Cirovski calls the analysis, helps him identify players who could be captains two to three years later, building a roster of future leaders.

PROTECT THE CHEMISTRY

After the 2001 season, Cirovski felt like he had a solid team in place. Rather than disturb team dynamics, he didn't recruit in 2002 for the following season.

The List

Here's where the most driven go-getters thrive

EDITED BY HARRY MAURER

Boeing

Staying Aloft On a Dream

Since 2001, Boeing has watched the airline industry nearly collapse, fired some 30,000 people, lost its No. 1 position in global aerospace to rival Airbus, and listened to the critics write its obituary. Oh, and by the way, to stay in the game it had to bet $10 billion on technologies that would make its next airliner lighter, faster, and cheaper to fly. Luckily, Alan Mulally, head of the Commercial Airplanes unit, never outsourced the company's essence: **the best and brightest engineers and designers in the business.** When Mulally, an engineer himself, let them loose, the result was the fuel-sipping 787 Dreamliner. The 250-seat lightweight, molded out of composites, has quickly become the fastest-selling new airplane ever—just when Airbus' self-inflicted damage has sent it crashing ignominiously to earth.

Latter-Day Saints

Stormin' Mormons

They believe their religion is the restoration of ancient Christianity, and they're eager to share it. Thanks to missionary zeal and terrific marketing, the Mormons have been big winners on the faith front over the past 50 years, **growing from 1.1 million members in 1950 to 12.6 million today**. Membership doubled between 1982 and 1998. Along with the globe-trotting Mormon Tabernacle Choir, the Church of Jesus Christ of Latter-Day Saints has a long-running series of heart-tugging "Homefront" ads that glorify the nobler aspects of family life. But those duos of well-dressed young volunteers who come knocking at your door are the real heart and soul of the effort to spread the faith. Of course, big-name Mormons help the brand, from the Osmonds to JetBlue Airways founder David Neeleman, hotelier J.W. Marriott Jr., and Dell CEO Kevin Rollins.

Goldman Sachs

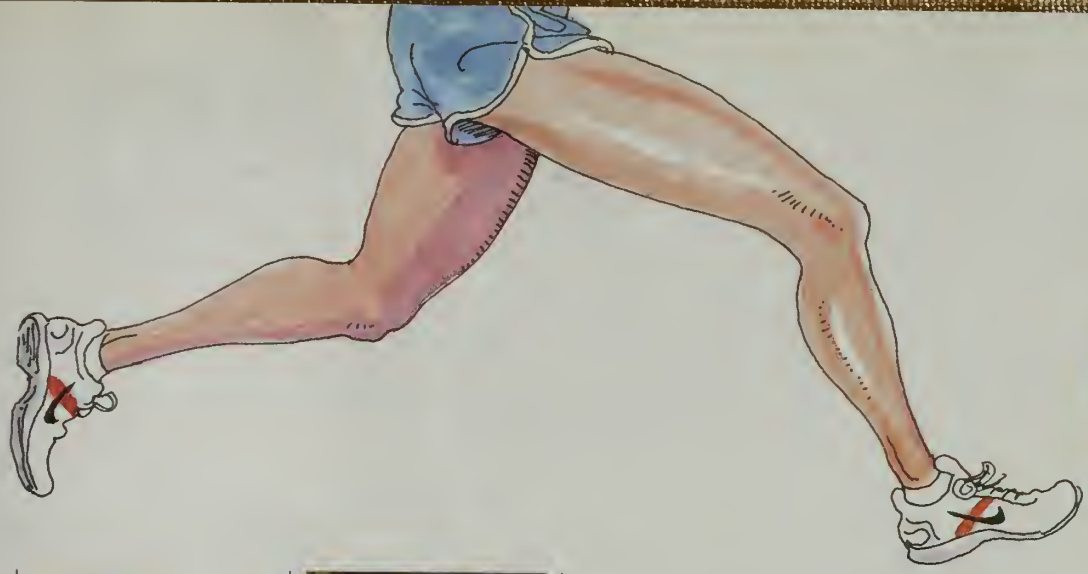
Winning on The Street

Who's afraid of Goldman Sachs? Try the rest of Wall Street. Every time opponents think they've figured out how the investment bank is beating them with blockbuster earnings, it bests them again. Goldman starts to hone its recruits' instincts by making them fight like crazy to get hired, a feat that just 5% of 16,303 applicants achieved last year. Once in, only the hypercompetitive survive 360-degree annual reviews. And **excruciating high-level analyses are conducted any time the bank misses out on a big deal** or a trading opportunity. Both former CEO Henry Paulson Jr. and recent successor Lloyd Blankfein are famous for sending missives to their troops round the clock. How about motivation? The bulk of each staffer's pay comes from cash bonuses and stock awards based on performance. Last year, Blankfein's $600,000 salary accounted for a minuscule 2% of his total $30.6 million in compensation.

Harvard

This Ivy Gathe No Moss

Harvard College doesn need to compete, right Students would kill to in there. Wrong: No university fights harde attract the best of the best. Harvard's campa begins in spring, when sends letters to no few than 70,000 high scho juniors with stellar SAT scores. William R. Fitzsimmons, dean of admissions, then dispatches an army of 8,000 alumni into the to help identify and



view applicants. He enlists Harvard ents and professors. 006, all this produced ar-record 23,000 licants, of whom just were accepted. Then, simmons launches a nd drive to persuade ucky few to say yes. payoff: This year, vard grabbed 80%, a rate that's the envy of elites. Harvard has lots urels, but it sure sn't rest on them.

el

ghting ipmaker

mer Intel Chief cutive Andrew Grove d to do it with shouts curses. His successor, ig Barrett, carried a eball bat. **Current CEO il Otellini rallies the ps through blogs and mos.** Anyone who has ked with, for, or against world's biggest maker has found that atever the method, Intel arsome. New hires are ed into often ifrontational situations l earn kudos for only outcome—being No. 1. a while, Intel seemed ave lost a step in its e with smaller rival anced Micro Devices. why has AMD stock n limping lately? ause Intel is arming for rice and innovation war. ce your bets.

Microsoft

Brutal Grillings, Killer Apps

Forget that regulators in the U.S., Europe, and Asia have accused Microsoft of violating laws to defeat rivals. And forget that its two best moneymakers, Office and Windows, are monopolies. If you really want to understand Microsoft, sit in on one of its legendary product review meetings, where its fiercely competitive DNA is laid bare. Managers spend weeks preparing for an interrogation that often stretches into the wee hours. **Chairman Bill Gates and CEO Steve Ballmer pick apart business plans the way vultures peck at a carcass.** The reward for those who survive and get funding: a chance to compete in the marketplace. There's little doubt about which is more difficult.

Navy SEALs

Don't Mess With These Guys

Officially, the first phase of the nearly year-long regimen for becoming a Navy SEAL is called Basic Conditioning. That's an understatement if ever there was one. During those eight weeks recruits endure "surf torture" (immersion in 60F water),

"drown proofing" (a series of underwater exercises with hands and feet tied), and the infamous **"Hell Week," 5½ days of sheer agony during which trainees sleep for a total of four hours.** No wonder just 25% of those chosen to enter the harrowing process actually finish.

Nike

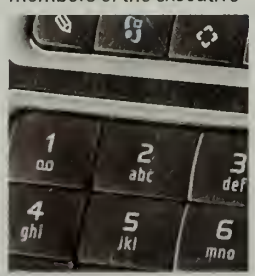
Behind That Runner's High

Many try, but few can run with Nike, a company that can handle defeats in the market and absorb global economic bumps without too much pain. It's clear that Adidas outpaced the Swoosh at this summer's FIFA World Cup in Germany and that higher oil prices are squeezing margins. **But even a setback in the key soccer category hardly trips up this marathon runner.** Nike veteran and new CEO Mark Parker is steeped in Nike's hypercompetitive cauldron (a sign in the plush exercise and workout center reads: "No brand X. Wear the Swoosh, please"). He's expanding in Brazil, China, India, and Russia while speeding innovation with ozone-friendly Max Air cushioning and Nike Plus with Apple, a sensor that beams data to an iPod nano while you run.

Nokia

Hello, We're Listening...

You could easily mistake Nokia's headquarters outside Helsinki for a laid-back place. Workers sip cappuccino in a lounge where floor-to-ceiling windows afford soothing views of pleasure boats in a nearby harbor. **But you don't grab and hold the No. 1 cell-phone spot by being mellow.** Nokia has crafted a culture melding the Finnish work ethic with the openness needed to win in a business that is part fashion, part high-tech innovation. Mary McDowell, a Hewlett-Packard veteran who joined Nokia in 2004, remembers her amazement at how other

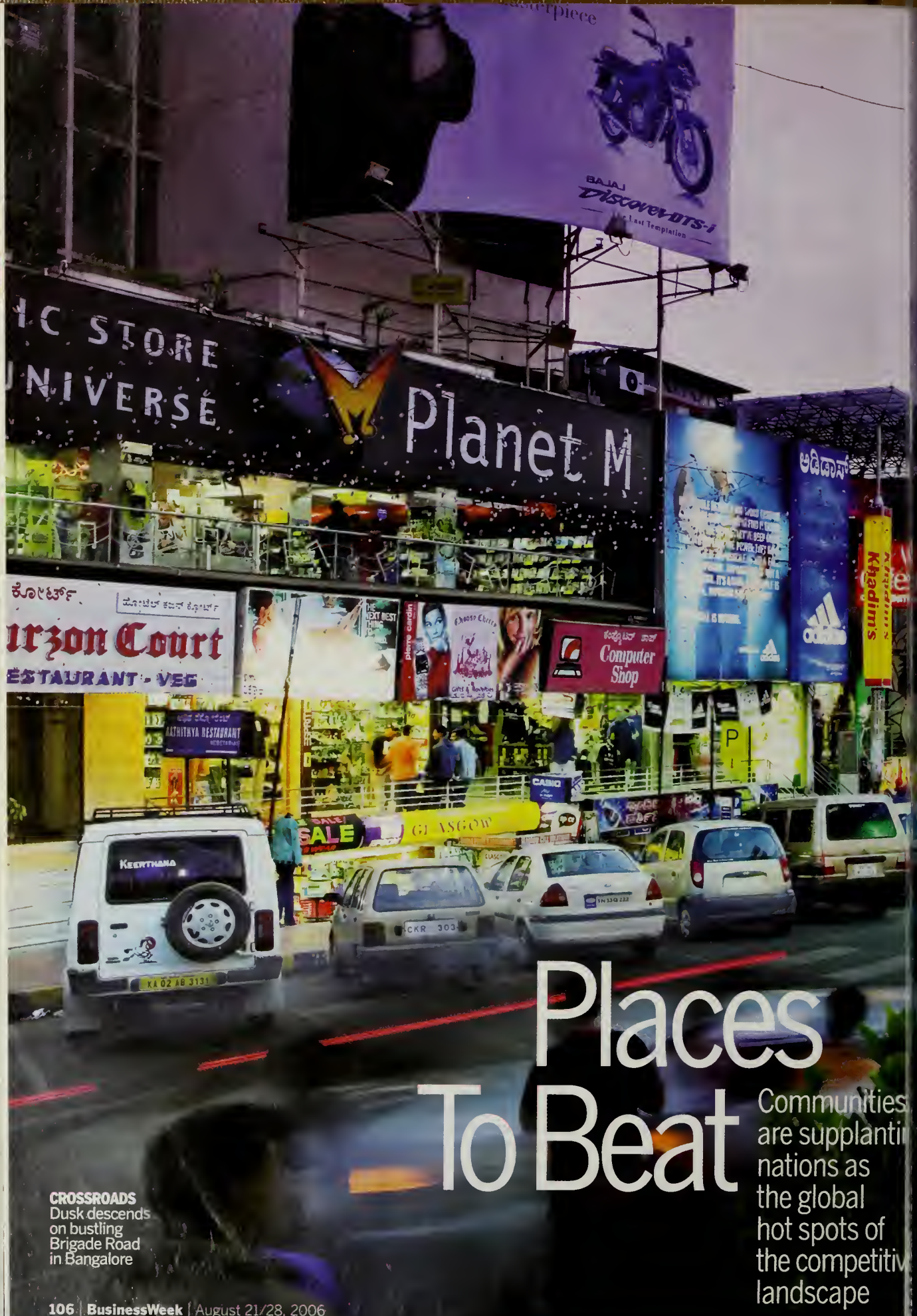


members of the executive board would gravely take the blame for mistakes. Top brass are also not too proud to mingle with common folk—from Chinese watermelon farmers to American mall rats—in their quest to figure out what customers want. The willingness to listen and admit error helped Nokia recover from product missteps a few years ago.

Toyota

Move Over, Range Rover

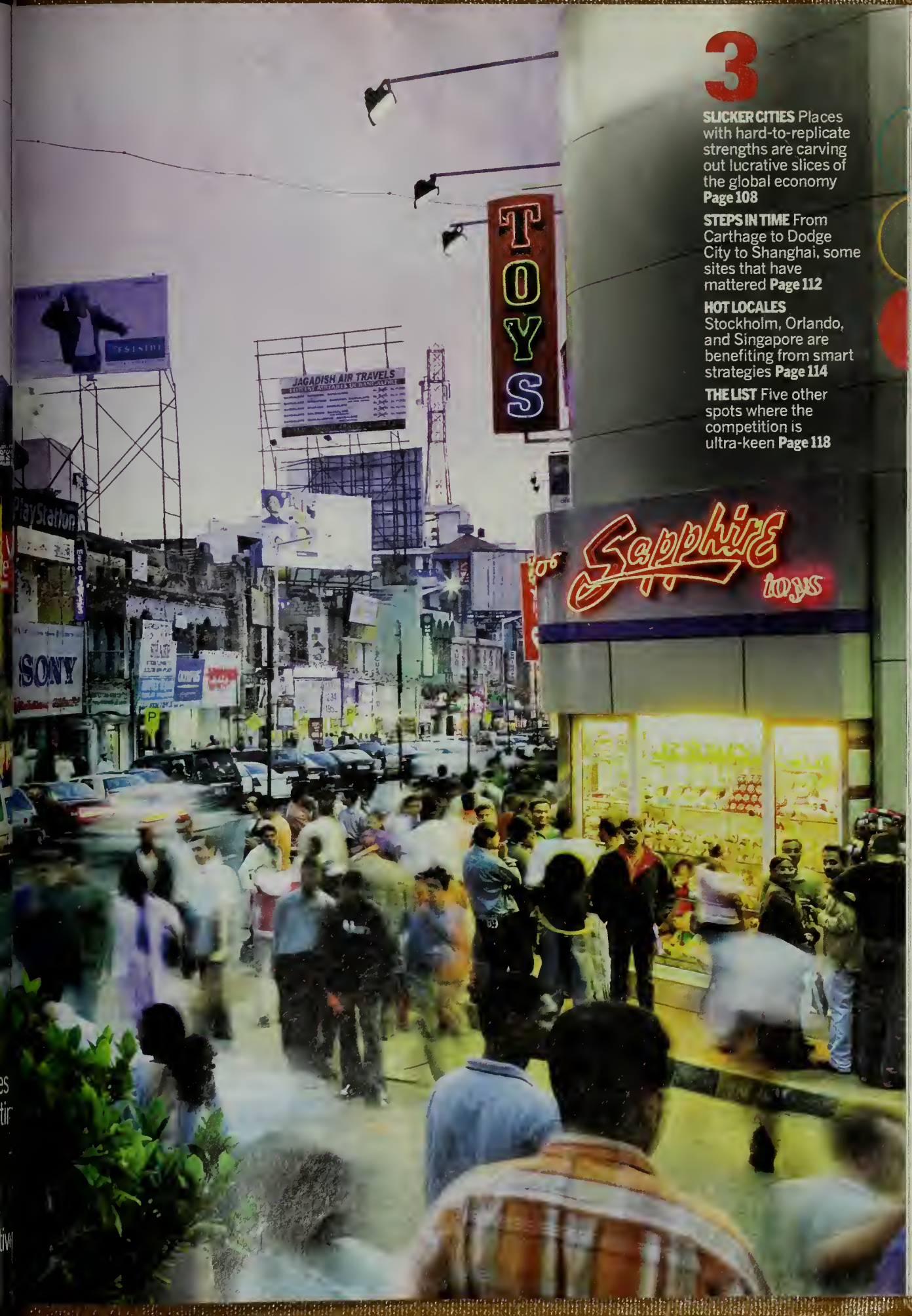
Toyota Motor chief Katsuaki Watanabe plays down suggestions that overtaking General Motors as the world's biggest auto producer is a top priority. But Toyota's growth push tells a different story. Last April, Watanabe's predecessor, then-Chairman Hiroshi Okuda, said Toyota would consider raising prices to help out struggling GM and Ford. Fine words, but by December, **Toyota was announcing plans to raise production 10%, to more to than 9 million vehicles this year, heaping more pressure on the Big Three.** Just as important is Toyota's obsession with cost-cutting. Before becoming president, Watanabe made his name as the architect of a plan that slashed costs by $10 billion in five years.



Places To Beat

Communities are supplanting nations as the global hot spots of the competitive landscape

CROSSROADS Dusk descends on bustling Brigade Road in Bangalore



3

SLICKER CITIES Places with hard-to-replicate strengths are carving out lucrative slices of the global economy **Page 108**

STEPS IN TIME From Carthage to Dodge City to Shanghai, some sites that have mattered **Page 112**

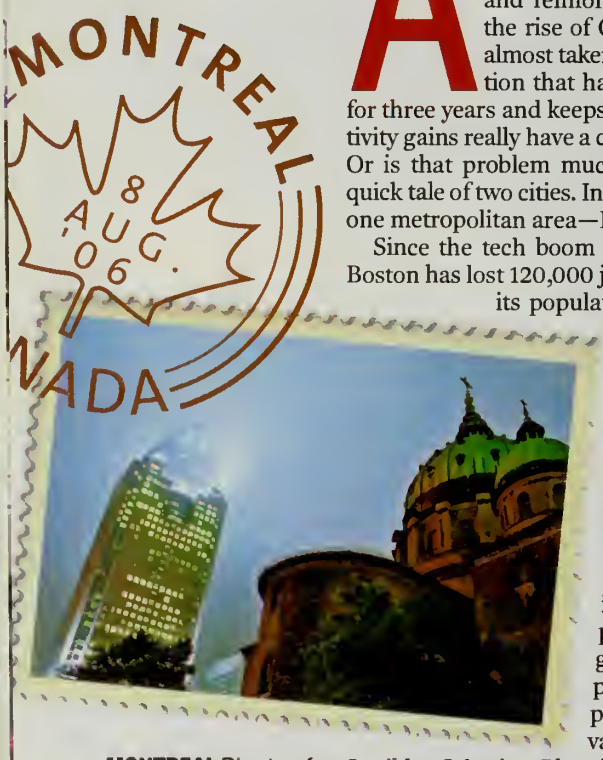
HOT LOCALES Stockholm, Orlando, and Singapore are benefiting from smart strategies **Page 114**

THE LIST Five other spots where the competition is ultra-keen **Page 118**

Slicker Cities

The real contest is among communities, not nations. Check out these hot spots

BY PETE ENGARDIO

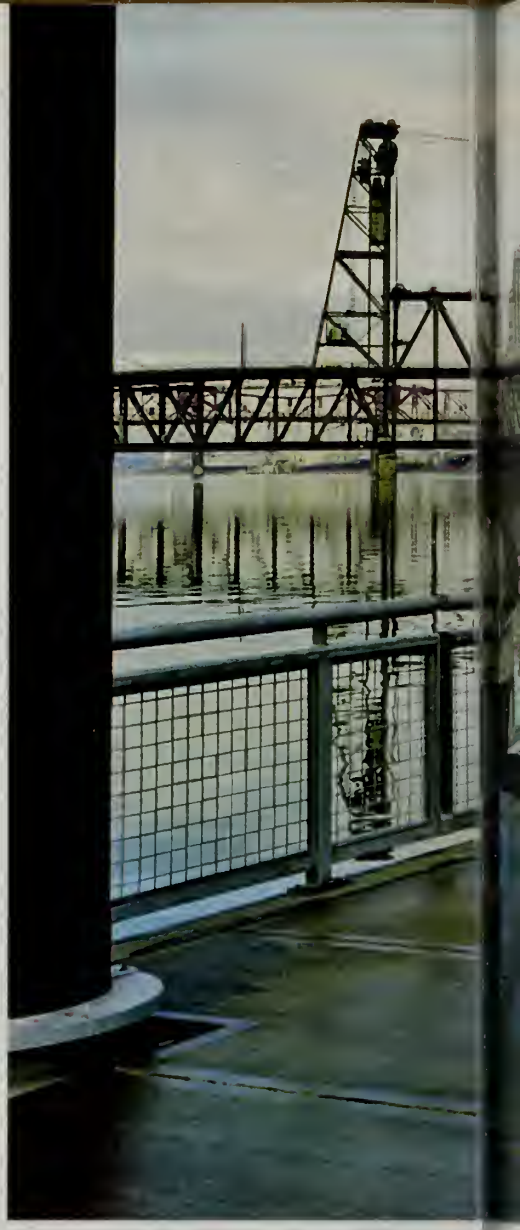


MONTREAL Plenty of tech grads, a lively arts scene, and low operating costs make it a haven for 3D imaging and animation

AMERICA IS LOSING ITS COMPETITIVE edge. That premise has been pounded into our heads so often by pundits, and reinforced with each report on the rise of China and India, that it's almost taken as a given. But can a nation that has averaged 3.4% growth for three years and keeps posting sterling productivity gains really have a competitiveness problem? Or is that problem much more local? Here is a quick tale of two cities. In fact, they are two cities in one metropolitan area—Boston.

Since the tech boom peaked in 2000, greater Boston has lost 120,000 jobs. It has also lost 5% of its population, a trend seen across Massachusetts, as young families, no longer earning enough to afford skyrocketing housing costs, moved out of the city and nearby blue-collar towns like Chelsea and Revere.

But right across the Charles River, Cambridge is booming. Local biotech powers Genzyme and Biogen Idec have been expanding their labs, as have pharma giants Pfizer, Novartis, Bristol-Myers Squibb, Schering-Plough, and Wyeth. Kendall Square, an old industrial district abutting the Massachusetts Institute of Technology that in the 1970s boasted overgrown lots and dirt-cheap rents, is now jammed with gleaming offices and restaurants like the Blue Room, where venture capitalists cut deals over lunch. The action "is just like Silicon Valley 10 years ago," says Noubar Afeyan, CEO of Cambridge-based Flagship Ventures, which works with more than 15 area startups. With 150 biotech compa triple what it had just three years ago, Cambrid perhaps the world's hottest life sciences hub. T no small feat: Forty U.S. states are targe biotech as a key industry, as are big-spending A and European governments.



The two metro Bostons illustrate the dyna of 21st century economic competition. The contest isn't between nations. It's between c munities, whether they be neighborhoods, ci or tight-knit regions. Those with hard-to-repli strengths are carving out lucrative slices of global economy. Cambridge's strengths inc MIT and Harvard, nearby top teaching hospi and vibrant urban environments where tale workers earn enough to support their lifest For biotech companies, says Afeyan, "This is a easy place to recruit scientists and manageme

The same dynamism is on display elsewh They don't talk much about declining comp tiveness in Portland, Ore., which is enjoying a h influx of designers, engineers, and entrepren drawn by its funky neighborhoods, miles of l paths, and recreation options. Nor in fast-grow Orlando, where a cluster of entertainment, a

PORTLAND, ORE. Funky neighborhoods, chic restaurants, miles of bike paths, and myriad outdoor recreation options are drawing designers and engineers

ace, and software talent has turned it into a rld leader in digital media. Montreal, Stock- Thlm, Atlanta, Raleigh-Durham, Edinburgh, gapore—all are thriving as magnets of knowl- Age workers and investment.

ocation, Location

OLD ON. WASN'T globalization supposed to ren- r location meaningless? Yes—in theory. A Silicon lley startup can do its engineering in Bangalore, anufacturing in Shanghai, and accounting in anila. Why live in pricey Manhattan if a creative rector can work remotely from Maine?

But in the end, companies and talent still tend to ster in areas rich in new tech sources, suppliers, d personal amenities. "The paradox of global- ation is that location still matters," says Harvard siness School competitiveness guru Michael E. rter. "The more barriers disappear, the more that pital and talent become mobile, the more decisive come geographic advantages." Areas most pun- ed by globalization, he notes, are those whose ographic advantages have ebbed, such as De- it's proximity to the Great Lakes. Factors that lure investment today, like good schools, roads, tax policies, and support industries, are controlled by communities, not national governments.

Farsighted communities everywhere are taking heed and raising their game. Cities up and down China's coast are lavishing perks on multinationals as they vie for new manufacturing. Nations like Romania are promoting their highly educated, multilingual workers in a bid to be a new Bangalore for outsourced software and back-office support.

In North America, though, communities must go beyond tax breaks, cheap land, and convention centers. Successful ones are hiring consultants to map detailed game plans to develop new industry clusters. They are amassing war chests to subsidize training, R&D projects, and even startup capital. Local agencies are breaking down silos among universities, corporations, and cities across entire regions to collaborate on development.

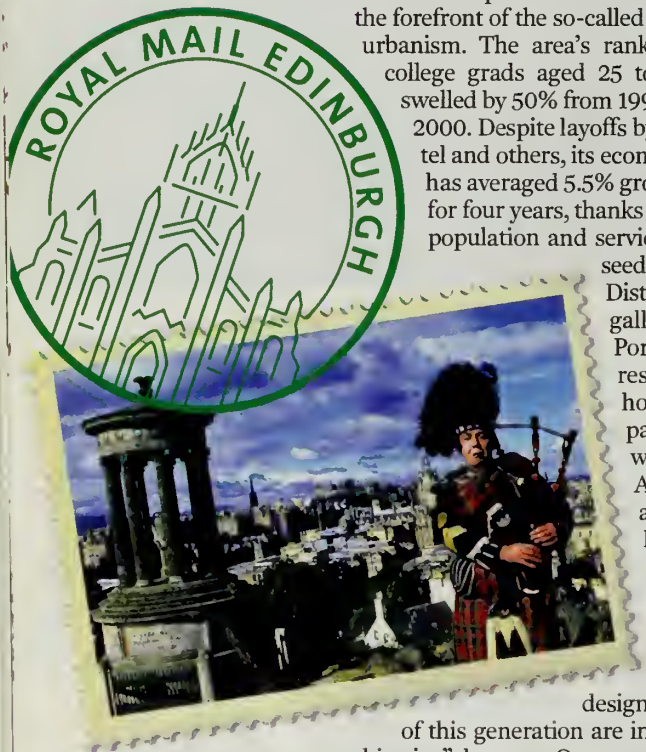
Communities also are putting much heavier emphasis on attracting college grads aged 24 to 34. "They are the dream demographic of a fast-growing economy," says Joseph Cortright of Impresa, a Portland economic consulting firm that works with cities across the U.S. These young adults grew up

CAMBRIDGE, MASS. Thanks to hordes of students and a thriving biotech sector, says Flagship Ventures' Afeyan, "This is a very easy place to recruit scientists and management"

with computers, have up-to-date training, and are tomorrow's entrepreneurs. Research by economists such as Harvard University's Edward L. Glaeser shows that communities with high concentrations of college grads also have the strongest economies. Trouble is, young talent is scarcer as America ages. Two-thirds of U.S. metro areas have fewer 25- to 34-year-olds than a decade ago, Cortright notes.

To draw them, more cities are listening to George Mason University public policy professor Richard Florida, author of the 2002 best-seller *The Rise of the Creative Class*. Many cities and states produce plenty of college grads, but they don't stay. To thrive, Florida argues, communities need urban areas attractive to bohemians: "Competitive advantage is shifting to places that are very open to allowing people to express themselves."

A case in point is Portland, at the forefront of the so-called new urbanism. The area's ranks of college grads aged 25 to 34 swelled by 50% from 1990 to 2000. Despite layoffs by Intel and others, its economy has averaged 5.5% growth for four years, thanks largely to the swelling population and services like design. Once-seedy areas like the Pearl District boast dozens of art galleries and some of Portland's fanciest restaurants. Old warehouses now house companies like Ziba Design, whose clients include Apple Computer, and ad agency Wieden + Kennedy.



EDINBURGH Ample startup capital draws a host of cutting-edge industries

Ziba founder Sohrab Vossoughi says a stimulating city center is key to his ability to hire 20 designers a year. "The values of this generation are in line with the DNA of this city," he says. One recruit is Vermont native Meral Middleton, 26. She likes that she can snowboard at Mt. Hood and hang out at chic restaurants. Her boyfriend, an Adidas designer, is one of 10,000 locals who bike to work. "Design is as much a lifestyle as it is a job," she says. "The time away from the desk may be when you find that epiphany."

But it takes more than fun urban centers and strong universities to thrive in most creative industries. It's no accident that cities like Orla Edinburgh, Montreal, and Los Angeles lead in geoning industries like digital media, for exam Each has lots of artists, film producers, and c puter whizzes. They also compete hard for inv ment. Take Edinburgh and nearby Dundee, capitals of Scotland's $5.2 billion digital media creative sector and home to gaming pioneers Time Worlds and Rockstar Games, creato *Grand Theft Auto*. The University of Abe Dundee offered the world's first computer gam degree, and the cities host top industry con ences and contests. Local banks and even S land's government offer startup capital. " many companies just on the cusp of success, a tle help can really be important," says Real T Worlds studio manager Colin Macdonald.

Canadian Sunrise

MONTREAL OFFERS ONE of North Ameri highest concentrations of tech graduates, livel arts scenes, and lowest-cost operating envi ments. And in recent years, it has become a m for animation and 3D digital imaging compa such as Digital Dimensions, InSpeck, Softim and Toon Boom Animation. Montreal also of some of the juiciest financial incentives arou The province of Québec rebates up to 37.5% o

used in developing a game. That helped entice tronic Arts to open a major Montreal studio. he growing willingness of local governments ump subsidies into key sectors is perhaps the lest challenge for U.S. communities to con- t. Singapore plans to invest $1.7 billion over years to be a biotech power, while India allo- d $2.3 billion for biotech initiatives last year. lorth Carolina's Research Triangle illustrates way communities are trying to meet the chal- ge. After enjoying explosive growth in the '90s, region's electronics industry was hit hard by 2001 recession and rising competition from na. And while the Triangle boasted 500 life sci- es companies and $2 billion in public and pri- R&D, an analysis by Harvard's Porter con- led that the region relied too much on nufacturing while it lagged in producing new panies, products, and jobs. "He basically said don't have a clue where we are going," says rles A Hayes, CEO of investment promotion up Research Triangle Regional Partnership. o state and local agencies in 2003 drew up a ster plan. It includes spending $60 million to n 3,000 life sciences engineers, a new biotech nufacturing and education center, and collabo- ve efforts among universities, companies, and ernment agencies in 13 counties: Five years , each county had its own development plan. e used to think we were competing with each er," Hayes says. "We've realized our competi- is now global." ■

–With William C. Symonds in Boston and Olga Kharif in Portland, Ore.

HOW I COMPETE

Shirley Franklin

In her second term, Atlanta's Mayor champions public-private partnerships as key to making her city a magnet for talent and jobs.

We visit our competition. One hundred business and government leaders from across the region travel together once a year to a city. We take three or four day trips and meet with a cross section of community leaders. We go to learn what other people are doing well that we can duplicate or emulate. We also go to learn what didn't go so well.

What's been important to us is to understand what our strengths are so we can build on them, and to identify our weaknesses so we can work to improve them. We are forever looking for a competitive edge. Fortunately, Atlanta is a community that has had a close relationship between the public and the private sector. There are numerous examples of that going back 100 years, in which major initiatives have been spawned. To the extent that Atlanta is willing to borrow ideas from the private sector or other communities, we have an advantage.

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Timeline

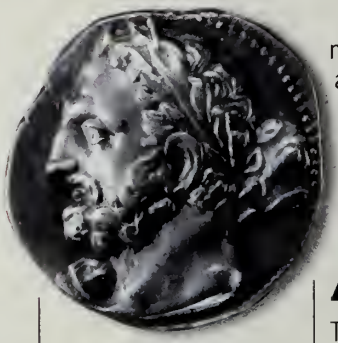
What does it take for a community to make its mark? Some strategic advantage whether it's location, intelligent leadership, a talented population, or all of thes Here are a few places that have mattered over time

BY HARDY GREEN

400 B.C.

Carthage

Located on the North African coast in what is now Tunisia, Carthage came to dominate the western Mediterranean. Two large artificial harbors facilitated a lively trade in textiles, farm products, fish, and slaves. Its prospectors also mined rich mineral deposits in Spain. But beginning in 264 B.C., Carthage was challenged by an even spikier foe, Rome. At the conclusion of the Third Punic War (around 150 B.C.), Rome's legions reduced



Carthage to a heap of smoking rubble and forbade anyone to ever again build on the site.

1300

Florence

Sure, Florence was home base for legendary artists, from Michelangelo to sculptor and architect Brunelleschi. But how do you think it could afford such prima donnas? Lacking a port and cursed with poor soil, Florence developed a dynamic economy based on financial services and woolen manufacture. By the 14th century, the city was an economic powerhouse, with trade that extended from England to the Black Sea. And the locals had lots of novel ideas—double-entry bookkeeping and maritime insurance among them—later recognized as cornerstones of capitalism.

1650

Amsterdam

Talent matters: Thanks to religious and economic refugees from Spain, Portugal, and Belgium, the cosmopolitan city of Amsterdam (below left) experienced a Golden Age in the 17th century. It became the Continent's financial center. Dutch mariners sailed the globe, establishing colonies in the Dutch East Indies, plantations in South America and the Caribbean, and an outpost called New Amsterdam in North America. By mid-century, the Dutch had more seagoing merchant vessels than England and France combined.

1830

Manchester

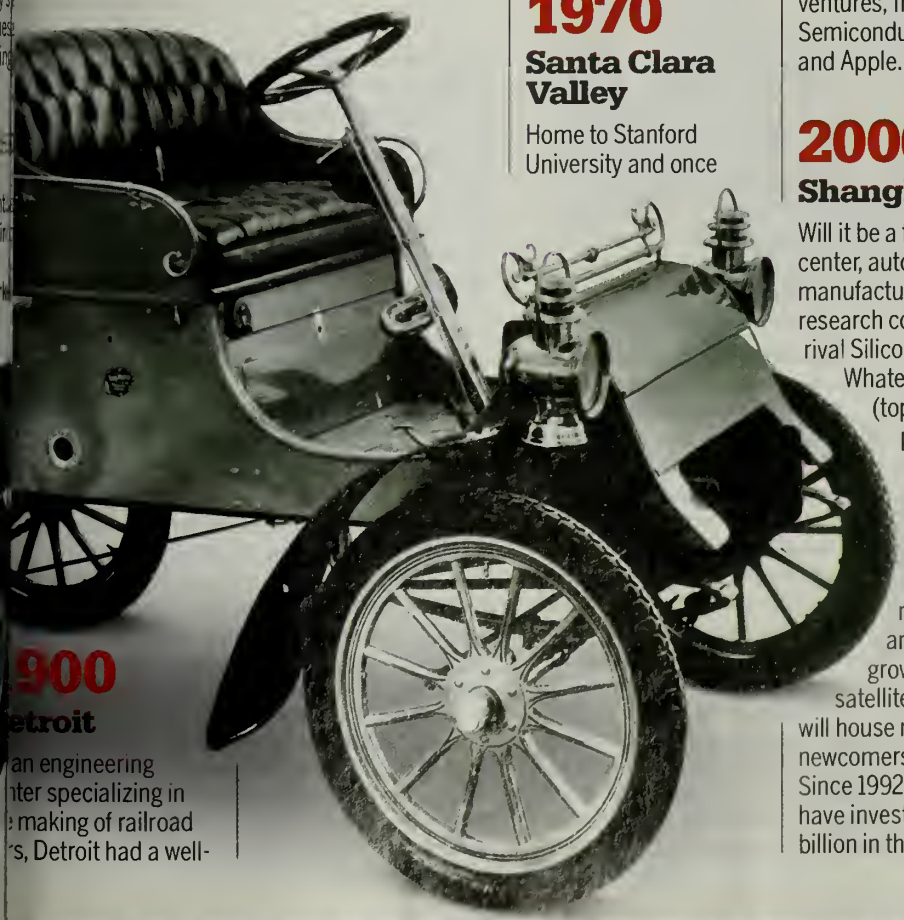
In its time, this was the greatest industrial city on the planet. Behir the English city's ris numerous streams providing the water power to turn hundr of mills, local handi traditions, and a lar group of entreprene already in possessi the necessary capit Vital, too, was a cult favorable to continu mechanical innovat including John Kay's flying shuttle, Jame Hargreaves' spinnin jenny, and Samuel Crompton's mule (above, right). By 18 the city contained 300,000 inhabitant and almost one-thir of England's manufacturing work

875
dge City

in 1865 as an army and formally ded in 1872 as a for buffalo hunting, ge City, Kan., was pportunist town ordinaire. By the 1870s, the great s of buffalo had

n destroyed. But nection to points via the railroad wed Dodge to evolve a cow town. Over next 10 years, 5 ion cattle were driven e up the Chisholm Western Trails.

established tradition of subcontracting and a ready supply of skills. Henry Ford, the key pioneer in automobile assembly line production, combined these with other resources, including



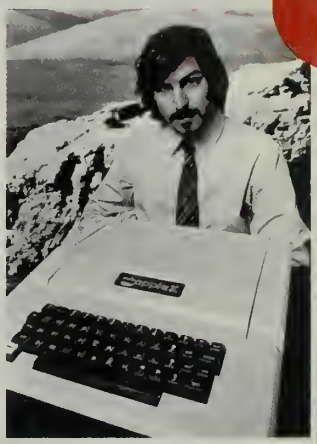
900
etroit

an engineering nter specializing in making of railroad s, Detroit had a well-

venture capital from local grandees and the energy of a community of pioneer-inventors and engineers. But equally key was an influx of labor: World War I arms production drew to town a huge number of workers, notably African Americans from the South. Between 1900 and 1930, Detroit's population soared from 265,000 to over 1.5 million.

1970
Santa Clara Valley

Home to Stanford University and once known primarily as the prune capital of the U.S. In the 1950s a few small electronics firms located here. By 1971 the area's innovations in solid-state electronics had prompted a new name: Silicon Valley. Later, a large supply of knowledge workers and the entrepreneurial instincts of those like Steve Jobs (right) led to the area's pattern of breakaways forming successful new ventures, from Fairchild Semiconductor to Intel and Apple.



2006
Shanghai

Will it be a financial center, auto-manufacturing hub, or research community to rival Silicon Valley? Whatever, Shanghai (top) is in a period of explosive growth, sporting a mind-bending new skyline and a fast-growing group of satellite towns that will house millions of newcomers by 2010. Since 1992 foreigners have invested over $100 billion in the city.

Pushing for Growth: How Cities Succeed

Stockholm, Orlando, and Singapore all sized up their assets, decided where they wanted to go, and figured out the best way to get there

EVEN WITH GLOBALIZATION, location still matters in economic competit But it is more important than ever for communities to offer distinctive vantages. Here are three examples of development strategies. Stockh shows how to succeed in the Knowledge Economy: It serves as a base major companies and tech universities, it subsidizes broadband, and it fers a vibrant urban environment that lures young talent. Orlando has diversi its economy by nurturing a new industrial cluster: digital media. Singapore thr by persuading multinationals to use it as a base for R&D and as regional he quarters, and even anticipates companies' needs five years out.

CREATIVE Designer Reed Kram set up shop in Soldermalm

Stockholm: Mecca for Affordable Talent

BY STANLEY REED

WHAT MAY BE the most competitive stock exchange company in the world is based in a huge, renovated former Ford Motor Co. plant in a suburb of Stockholm. "To succeed, we need to do something special," says Jenny Rosberg, president for company services at OMX, owner of the Stockholm exchange. OMX is so good that it operates six other bourses in nearby countries and now provides cutting-edge trading technology to more than 50 markets spread from Switzerland to Singapore. OMX itself is pulling away from the New York Stock Exchange and NASDAQ in trading volumes of Finland's Nokia and Sweden's Ericsson—companies with a large number of U.S. sharehol

Cities, too, need to offer something speci succeed in the 21st century, and Stockholm ha on a potent combination of livability and hi valued skills. Stockholm is a safe, pastel-sha place of nearly 2 million built around a harbo clean that you can catch salmon from footbri downtown. It's also a talent mecca for key t nologies, especially telecommunications, tha to the presence of phone-equipment giant E son, innovative telecom operators like Tele2, startups such as Nanoradio, where Eric alumni develop chips to turn mobile phones entertainment centers. Such companies l helped push Sweden's research and developn spending to 4% of gross domestic produ among the world leaders.

With its international outlook, fluency in E lish, and strong science and engineering sch like the Royal Institute of Technology, Sweden always going to be a global player. But in re years the government has taken some spe steps that have paid off handsomely. Policyma deregulated the telecom industry, awarded called third-generation mobile licenses chea and subsidized personal computers and br band networks. The moves helped boost Swe to near the top of the global charts in comp ownership, fiber-optic networks, and mol phone penetration. The government also

ed foreign capital, leading to the late-1990s overs of Volvo by Ford and drugmaker Astra Britain's Zeneca. From 2001 to 2004, Sweden acted $65 billion in foreign investment, a ng showing for a nation of 9 million. And while den has a reputation for being pricey and x-tax, its cost of living and salary ge are actually near the bottom of the e for the West. Swedish telecom and ngineers come about 40% cheaper their counterparts in Japan and earn less than those in the U.S., accord- to compensation consultants Watson tt Worldwide. Sweden, says Karl-Henrik dstrom, Ericsson's executive vice-president chief financial officer, is "one of the most ex- sive [locations] for unskilled labor and one of most inexpensive for skilled labor."

POPULATION
2 million
INDUSTRIES
Telecom, design, fashion

tockholm's tolerant, nonhierarchical culture articularly suited to responding to the rapidly nging demands of the 21st century market- ce. "We have a 'just do it' approach to rything; titles are not so important," says cael Schiller, managing director of Acne Jeans, tockholm-based designer label that sells in high-end stores such as Barneys in New York.

This can-do approach has helped apparel makers like Acne and Cheap Monday build international businesses with just a few employees. Web advertising shop Farfar competes for global accounts such as Nokia with a fraction of a New York or London staff. The payoff of this activity is strong growth. While Sweden's GDP is expanding at 4%, Stockholm's is probably cruising along in the 6%-to-7% range, estimates Peter Egardt, president of the Stockholm Chamber of Commerce.

The new wealth is transforming the once-dowdy city as well. One example is Sodermalm, the old manufacturing district where designers and architects now have their offices in renovated factories. American Reed Kram, a senior partner in the Sodermalm design firm of Kram/Weisshaar, has worked on everything from changing rooms for Prada's Beverly Hills store to the podiums for the convention of Sweden's ruling Socialist Party. While Stockholm has top creative people, he says, you don't get overwhelmed the way you might in New York. "It's nice to be avant-garde in a place that is a little more traditional."

rlando: A Real World f Simulation Shops

PETE ENGARDIO

A NEW GAME UNDER development at Electronic s Inc.'s Orlando studio, Superman rockets ough an 80-square-mile cityscape, honing his ay vision and strength to save Metropolis from villain Parasite. On Walt Disney World's back a team for digital media firm i.d.e.a.s. is finish- a realistic simulation of a 12-hour crisis aboard U.S. Navy frigate. Near Orlando's airport, inees at Adacel Systems Inc. maneuver virtual eing 747s over Milan, New York, and Denver. Every year 52 million tourists stimulate their aginations at Orlando's amusement parks. But real fantasyland can be found in the area's vast panse of office parks. Orlando is the epicenter of the world's biggest cluster for computer simulation and modeling, involving more than 3,700 companies that employ 46,000. The $2.6 billion sector has helped diversify the economy of central Florida, which now has the highest job growth in the U.S.

METRO POPULATION
1.9 million
INDUSTRIES
Tourism, film, digital media, computer simulation

Orlando largely can thank good fortune: It has long been me to film studios, defense industry simulation nters, and high-tech theme parks. It's also close three of America's 10 biggest universities: Flori-, Central Florida, and South Florida.

But the city also illustrates the effort needed these days to build new industries. It offers tax credits for everything from researchers' wages to capital equipment. It collaborates with colleges, government agencies, and companies in a 23-county area in the Florida High Tech Corridor Council. Aware that young creative types prefer stimulating urban environments, Orlando has transformed its once-sleepy downtown with posh new residential and retail districts. Says Mayor Buddy Dyer: "Sun and low taxes aren't the only things companies look for anymore."

Downtown's centerpiece is the Florida Interactive Entertainment Academy, a graduate school devoted to video game design. The former convention center is now filled with studios, game-development equipment donated by Microsoft Corp., and work spaces where artists, software programmers, and producers brainstorm. The 70 students learn to develop game prototypes in their first term. "We run a

ARMY TOYS A West Point cadet trains at a military simulation center in Orlando

16-week boot camp," says Executive Director Ben Noel, an ex-Electronic Arts executive. Students even get involved in a commercial game launch.

Such efforts are deepening the talent pool. Three years ago, when EA wanted to expand its famed Orlando studio Tiburon, which created the blockbuster *Madden NFL* game, "it was a hard sell" to recruit developers, says EA Tiburon Government Affairs Director Craig Hagen. "What happened here is a real transformation." EA has since quadrupled its Orlando staff, to more than 600, with half of the recruits coming from out of state.

The military also taps Orlando's workforce training. In one game under development for U.S. Army, a bomb wounds five soldiers on a Ba dad street. Medics get 10 minutes to diagnose treat the victims amid screams and gunfire. A N crisis simulation by i.d.e.a.s. will be enacted abc a mock ship and require cadets to extinguish f hunt intruders, and rescue injured seamen. ' could not relocate the core of this company a where else," says i.d.e.a.s. Principal Executive Allen. "Either we would not be able to find the ri talent, or the costs would bankrupt us."

Singapore: Reeling In The Multinationals

BY ASSIF SHAMEEN

WHEN HEWLETT-PACKARD CO. wanted to open a 10-employee center to manage licensing of its intellectual property to Asian tech companies, putting it in Singapore was a no-brainer. First, the Singapore Economic Development Board (EDB) hired two dozen local engineers itself, then it footed the bill for their training at HP labs in the U.S. Only when HP opened the center in April did the U.S. company have to decide if it wanted to hire these engineers or not.

When it comes to competing for multinational investment, few communities on earth roll out the red carpet like Singapore Inc. Generous tax breaks and affordable land are just the starting points. The EDB, the city-state's superagency for snaring investment, also often kicks in staff-training costs, research grants, and equity capital, if it's desired. The EDB's staff of 450 even hires consultants and interviews executives to anticipate the needs far in the future of prized tenants such as HP, which has been in Singapore for 30 years and has made the island its global base for laser printers.

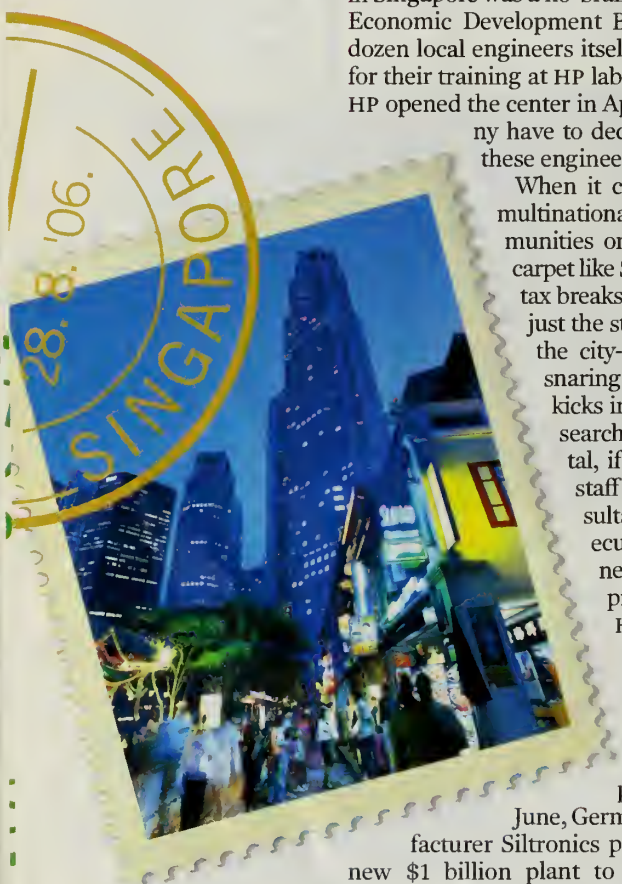
The approach has paid off handsomely. In June, German silicon wafer manufacturer Siltronics picked Singapore for its new $1 billion plant to make 300mm silicon wafers, even though key client Samsung Electronics Co. originally preferred South Korea. Other recent trophies include an animation studio by Lucasfilm, a Matsushita plant to make 42-inch-plus plasma TVs, a number of Asian computer game companies, a Rolls-Royce fuel-cell development venture, and a BMW auto design studio—the last being quite a coup, considering Singapore has domestic car industry. For Denmark's Ves Wind Systems, which recently announced a 1 engineer R&D facility, the clinchers included chance to collaborate with local universit which will team up with the EDB to cover alm all of Vestas' research costs. The Danes even permission to install prototype windmills in S gapore. "The EDB offered us almost everything wanted and more," says Vestas Asia Presid Thorbjorn Rasmussen.

The result is a remarkably diverse economy a nation of 4.5 million. Singapore is post strong growth in everything from banking and gistical services to pharmaceutical and oil manufacturing. China may be the world's wo shop, but manufacturing still makes up more th a fourth of Singapore GDP.

POPULATION
4.5 million
LANGUAGES
Mandarin, English, Malay
INDUSTRIES
Electronics, drugs, banking

Singapore's approach is try to think far ahead about h industries and individual co panies will evolve. "If we kn what Motorola or HP is going do over the next three to years globally, we can shape policies so that we have eve thing they need in place quickly implement their plan says EDB Chairman Teo Ming Kian. For exam the EDB is working with Seagate Technology on company's next generation of hard drives. The S gaporeans are involved in everything from desig developing prototypes to building the first glo manufacturing facility for the new drives.

Singapore also backs its visions with big mo Often that means becoming a financial partner w multinationals. In the late '90s, Singapore becam chip player by taking equity stakes in silicon wa foundries with companies like HP, Micron Techn ogy, Canon, Royal Philips Electronics, and Taiw Semiconductor Manufacturing. When aircraft gine maker Rolls-Royce wanted to set up an R center for fuel cells last year, the EDB lined up search grants and a consortium of local compar to form a $110 million joint venture. "Every cour in Asia is chasing the same multinationals," s Dominic Barton, Asia Pacific chairman of cons tancy McKinsey & Co. "But Singapore has the cle est strategy on what it wants and is very focused getting it."



ASIAN MAGNET The city-state rolls out the red carpet for foreign investment

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The List

Five more spots that have honed competition to a fine art

EDITED BY HARRY MAURER

Dubai

Mideast Crossroads

No Thoroughbred is too costly and no scheme too far out for this tiny emirate's ruler, Mohammed bin Rashid al Maktoum. On the barren shores of the Persian Gulf, he has constructed **a steel-and-glass oasis that offers a dynamic amalgam of Western, Asian, and Arabian cultures.** Dubai's relatively liberal mores and regulations lure individuals, businesses, and capital eager to escape the restrictions of nearby Saudi Arabia and Iran. There are potential Achilles' heels: Laborers imported from south Asia to work for low wages are growing restive, and a sharp drop in oil prices would hurt. But in just a decade the sheikh has turned a middling gulf entrepôt into the financial and retail epicenter of the entire oil-soaked Middle East.

New York

If I Can Make It There...

New Yorkers breathe competition. They fight for parking spaces, taxicabs, apartments, hot tickets, dinner reservations, and spots in choice public or private schools. They come by the adjective "pushy" honestly, in the trenches of a status-obsessed city. **These days, the Big Apple is even governed by a billionaire,** Mayor Michael Bloomberg, who made his money at the nexus of the two great industries that give New York its global clout: Wall Street and the media. But the purest New Yorker may be The Boss, George Steinbrenner, for whom anything less than a World Series title is beneath contempt.

Bangalore

India's Incubator

When you think Bangalore, you think call centers and software outsourcing. But the city has moved far beyond those sectors to become one of the world's key innovation hubs, home to entrepreneurs with radical business models for everything from budget air travel to medical services. Huge R&D centers for the likes of Intel, Cisco, and Motorola are helping dream up next-generation products. **Venture capitalists, private-equity funds, and Silicon Valley lawyers are flocking in.** And Bangalore has become such a magnet for young achievers that it's pushing aside Bombay as the arbiter of consumer-goods cool in India.

Shanghai

Laptop Maker To the World

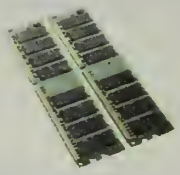
While the world has long known about free-wheeling Guangdong and the Pearl River Delta export base across the border from Hong Kong, **a rival has emerged up the coast.** It's greater Shanghai, which includes the fast-growing neighboring cities of Kunshan, Suzhou, Wuxi, Hangzhou, and Ningbo and exports everything from semiconductors to textiles. Known for being cleaner and safer than Guangdong, the regior makes a thumping 83' the world's laptops, sa researcher iSuppli. An China drives to develo hinterlands, greater Shanghai plays a key r supplying goods to the Yangtze River Delta, a region that stretches upriver to Chongqing.

Silicon Valley

How a Hotbe Keeps Cookin

Ask anyone in this blar expanse of suburban sprawl what makes Sil Valley special, and you get the easy answer: People here love risk. E that's only half of it. **Wh really keeps the fablec tech incubator vital is how many elements combine to slash the r of startup.** One: a read supply of entrepreneur brainiacs from Stanfor and the University of California at Berkeley. more venture capital th anyone knows what to with. Three: an unmatc network of startup services, from lawyers cubicle installers to dental-care vans for crazy-busy employees. Upstart centers like Inc Bangalore and China's Shenzhen may be set t mount a challenge, but there's still no place tha can build world-beating companies faster and easier than the Valley.

OCEAN FCL FROM SINGAPORE



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SEOUL, SOUTH KOREA

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TOKYO, JAPAN

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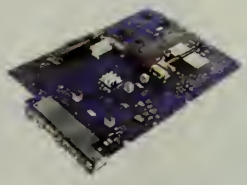
SHENZHEN, CHINA

OVERNIGHT FROM
MONTERREY MEXICO

OVERNIGHT FROM
REDMOND, WA



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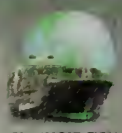

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An alternative look at the struggle to achieve

THE ABCs OF ADRs

INVESTING IN FOREIGN STOCKS

Americans just love to buy foreign – Japanese cars, Swiss watches, Russian caviar, Swedish vodka, Saudi oil, Colombian coffee, New Zealand lamb, French perfume, Italian fashions, computer components from Singapore, and lots of good things from China.

And when it comes to investing, America's appetite for foreign equities has also been growing. By the end of this year's first quarter, U.S. investment in non-U.S. equities totaled $3.27 trillion – up from just $19 billion in 1980. Although foreign shares now account for 17.1 percent of total U.S. equity investment, many leading investment advisors recommend still-greater international diversification of U.S. stock portfolios.

Alec Young, Equity Market Strategist at Standard & Poor's, for example, recommends 30 percent of American equity portfolios should be in non-U.S. stocks. S&P says four-fifths of this should be in developed markets like Europe, Japan, and Canada, with the remaining one-fifth in emerging markets like Russia, India, China, Mexico, and Brazil.

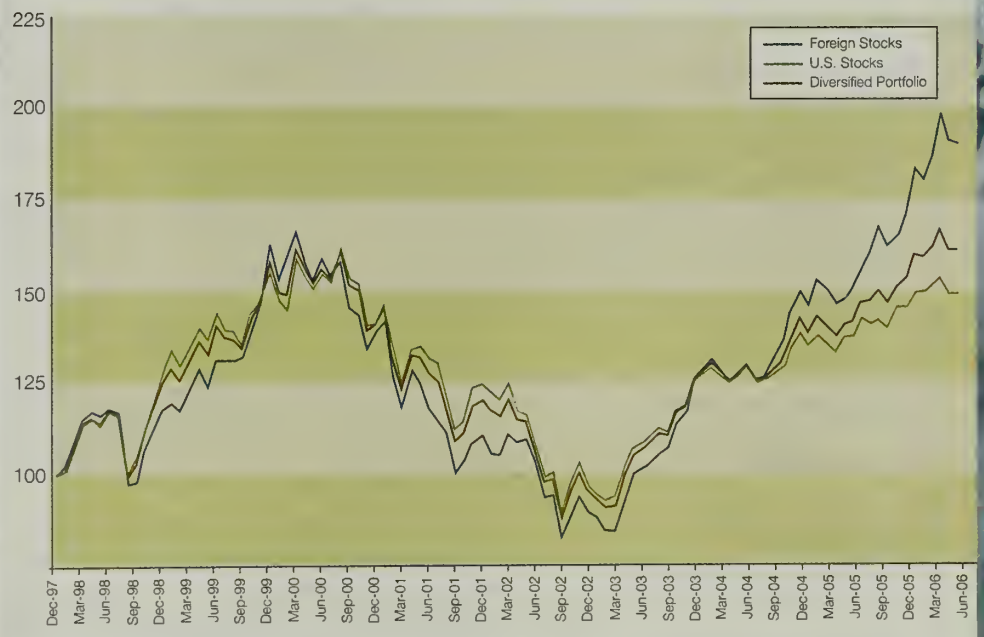
WHY DIVERSIFY?

One good reason for Americans to increase their holdings of foreign equities is risk reduction. Just like holding a variety of stocks in different industries reduces volatility and risk in domestic-only equity portfolios, diversification across countries and regions provides investors with similar protection. A sell-off in one market prompted by bad news, local politics, or business cycle developments will often be mitigated or offset by stronger performance elsewhere, smoothing out the ups and downs in the value of a geographically diverse portfolio.

In fact, American investors who invest only in U.S. equities are pursuing a riskier long-term strategy. Not only are they missing opportunities in more than half

ADRs vs. U.S. STOCKS Relative Performance

ADRs have outperformed U.S. Equities in recent years but have had greater price volitility



Notes: Foreign Stocks represented by S&P ADR Index. U.S. Stocks represented by S&P 500 Index. Diversified Portfolio is 30% foreign stocks and 70% U.S. stocks. All indices include reinvested dividends. Source: Standard and Poor's

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THE ABCs OF ADRs

INVESTING IN FOREIGN STOCKS

the world, measured by recent stock market capitalization, but when the U.S. cycle shifts into reverse, Americans who do not own foreign shares won't benefit from the better performance likely in at least some national stock markets around the world.

Cyclical prospects for the major industrial economies suggest now is a particularly good time for Americans to step up their non-U.S. equity holdings. The United States economy is late in its cyclical expansion phase when growth in personal incomes, output, and profits usually slow and aging bull markets begin to falter. In contrast, Japan's business cycle upswing is still young when prospective growth in corporate earnings typically supports rising equity prices. And, Europe is somewhere in between, showing resilience in personal incomes, corporate profits, and investor optimism. Apart from cyclical developments, European equities should continue to benefit from a wave of cross-border restructuring and the merging of national markets for European goods and services.

There are other good reasons for American investors to look abroad. S&P portfolio strategist Alec Young puts prospective dollar depreciation at the top of the list as narrowing interest rate differentials with Europe and Japan favor the yen and the euro. "So far this year most of the world's stock markets have been relatively flat," but Young points out that "international equity markets still outperformed the U.S. averages because of a declining dollar," a trend that many expect will continue for the next few years.

The various developments we've come to call "globalization" also suggest that now is the time for American investors to step up their exposure to foreign equities. Stock markets in many of the emerging market economies of Asia and Latin America are potentially the biggest beneficiaries. We are already seeing the secondary effects of globalization in these countries – a rise of consumerism, increasing demand for health and financial services, major infrastructure development (roads, rail and subway systems, ports, airports, power generation, etc.), and the rise of world-class corporations that can compete effectively against leading American, Japanese, and European companies. Importantly, these emerging market economies are so much smaller than the United States. At the same time, they are still early in their economic maturation and industrialization. These two factors suggest that their stock markets – despite their inherent short-term price risk – may register relatively attractive growth over the longer term.

HAVE I GOT A TIP FOR YOU?!

Now that you've read this far and are considering the world of international equities there are some important things you need to know.

To begin with, buying (or selling) shares of foreign companies directly on their home-country stock markets is not only cumbersome but it is generally more expensive. Americans will pay additional commissions not only to a foreign stockbroker but to a currency dealer, as well, to convert dollars into euros, rubles, yuan, pesos, reais, or whatever. U.S. investors will incur local brokerage and currency exchange fees again on the way out – and, since any dividends will be paid in local currency, investors holding dividend-paying stocks will suffer recurring currency exchange fees. What's more, U.S. investors may be subject to local tax withholding on dividends and capital gains.

To avoid the hassle and expense of investing directly in foreign stocks, there are a multitude of

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A wealth of information about DRs and international equities for both issuers and investors is available at JPMorgan's award-winning website, **www.adr.com**.

ADR Insights with James Keane

EMEA Regional Head, JPMorgan Depositary Receipts Group

Q: Why do foreign companies issue ADRs?

JK: Non-U.S. companies often issue ADRs to raise new equity capital in the United States. Sometimes a foreign company will launch an ADR program to create an "acquisition currency" to support prospective corporate acquisitions in the United States. And almost always, non-U.S. issuers of ADRs are pursuing other strategic objectives that potentially can have a positive effect on their company's market valuation.

Companies can also choose to list in either London or Luxembourg via a Global Depositary Receipt or GDR. In recent years, capital raising using GDRs has steadily increased.

Q: What strategic objectives might be achieved with an ADR program?

JK: A well-executed ADR program raises an issuer's visibility in the U.S. investment community, creates new demand for its shares and ultimately diversifies the company's shareholder base. Geographic diversification can reduce price volatility because selling in one region may be mitigated by demand in another.

Launching an ADR program makes sense for many companies that already have significant business interests in the U.S. – where a well-known brand name can be associated with its stock. For a consumer-oriented company with a presence in the U.S., greater visibility arising from its ADR program can be very positive for its commercial business. Companies with a strong brand image may attract consumers to become investors and investors also often become new customers.

Q: Is now a good time for non-U.S. companies to launch ADR programs?

JK: For a company that plans to raise new equity capital, enjoy brand-name recognition among U.S consumers, and is willing to bear the cost of adopting U.S. GAAP (United States Generally Accepted Accounting Principles), timing is very important. You want to take advantage of windows of opportunity when stock valuations are strong.

However, I would argue that timing is almost irrelevant for companies coming to the U.S. for reasons other than raising new capital. It's a long-term strategic decision. Raising visibility, diversifying the shareholder base, improving your market valuation – this is a multi-year effort. It may be easier to get started in a strong market when investor interest is high. However, if the issuer is not raising capital, it doesn't have to worry about selling itself short in a weak market.

Q: What about the cost to the issuing company of coming to the U.S. with an ADR program versus listing in their home stock markets?

JK: This is a relevant consideration. It can be costly for some companies to ensure that their financial accounts are in compliance with U.S. accounting standards and Sarbanes-Oxley regulations. The diversion of senior management time may be a significant intangible. And, a U.S. investor relations effort can have a sizable price tag.

However, for well-governed companies, greater disclosure and transparency promote investor confidence, improve credit ratings, and represent a "seal of approval" that, at the end of the day, can translate into premium valuations and lower borrowing costs.

Q: What role does investor relations play in a successful ADR program?

JK: A commitment to investor relations with resources devoted to the U.S. is essential for new as well as established issuers. More and more foreign issuers are recognizing that the success of their ADR programs – measured by a growing investor base and a healthy market valuation – requires a full-time U.S. investor relations effort.

Issuers with 20 or 30 percent of their shareholder capital in ADRs will want a full-time investor relations officer, if not a team, based in the U.S. to look after existing investors and market to new investors.

In addition, senior executives must take the time to visit institutional investors and securities analysts at least twice a year, if not more. Consumer products companies with recognized brands should also consider visits to retail stockbrokers in every region and attend the major retail investor conferences to develop support among individual investors.

THE ABCs OF ADRs

INVESTING IN FOREIGN STOCKS

mutual funds, exchange-traded closed-end funds, and exchange-traded index funds (ETFs) that offer U.S. investors easy access to foreign stocks. Some funds span the globe – holding what they consider to be the best stocks from a variety of countries and regions. Others invest in one particular country or region, or specialize in emerging markets or other selection criteria.

For many individual investors, selecting a diversified basket of foreign stocks – either an exchange-traded index fund or a mutual fund with a good track record from one of the major mutual fund management companies like Fidelity or Vanguard – is a safe way to benefit from foreign equity exposure.

There is a third way for U.S. investors to buy, hold, and sell foreign stocks – one that avoids dealing with overseas brokers and currency dealers yet offers access to individual companies for those who want to do their own international stock selection. American Depositary Receipts – or, simply, ADRs – make investing in foreign stocks just as easy as buying shares in Microsoft, Wal-Mart, or any other American company.

WHAT EXACTLY ARE ADRs?

American Depositary Receipts are negotiable certificates issued by a depositary institution like JPMorgan Chase representing ownership of securities of non-U.S. companies held outside the United States on behalf of

COMPANHIA VALE DO RIO DOCE – CVRD

Country: Brazil

Industry: Metals and Mining

Exchange: NYSE

Symbol: RIO (common) and RIOPR (preferred)

Market Cap: $53.9 billion

Recent Share Price: RIO $23.2(RIOPR $19.90

52-week range: RIO $16.24 - $29.(RIOPR $14.03 - $ 24.20

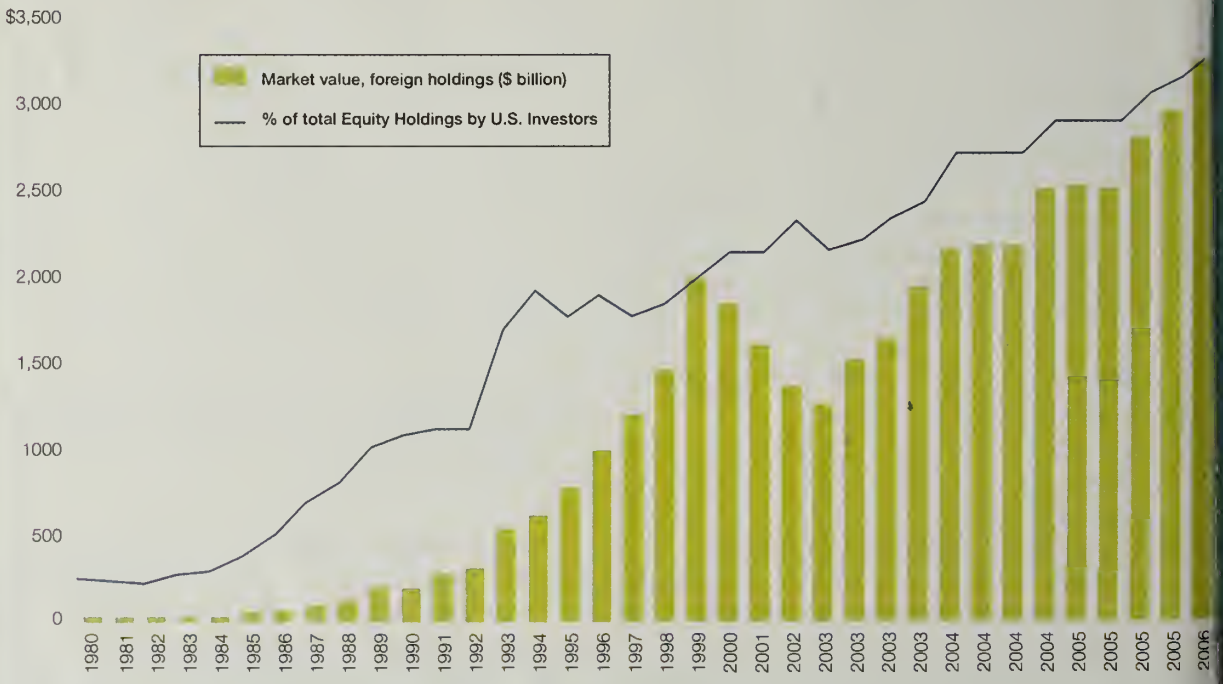
Info: www.cvrd.com.br

IR Contact: rio@cvrd.com.br +55-21-3814-4540

Key Facts: CVRD is the largest mini company in the Americas and one the four largest companies in the glc metals & mining industry. It is the wc largest producer of iron ore and pel and the second largest producer o manganese and ferro-alloys. It is al leading global player in bauxite, alur aluminum, copper, potash and kaol

U.S. INVESTMENT IN FOREIGN EQUITIES (ADR and local shares)

U.S. investment in foreign equities has risen from $19 billion in 1980 to $3.3 trillion in March 2006



Source: U.S. Federal Reserve

For CVRD the most important word is value: value for shareholders, value for people, value for the environment.

CVRD - Companhia Vale do Rio Doce is the largest metals and mining company in the Americas. Headquartered in Brazil, it supplies the global market with products present in the daily lives of millions of people around the world. The world's largest producer and exporter of iron ore and pellets, CVRD is a leading global player in manganese, ferro alloys, bauxite, alumina, aluminum, copper, potash and kaolin. It is also developing coal and nickel projects aiming at being a major global player in these products. As Brazil's main supplier of logistics services, the Company owns and operates railroads, maritime terminals, warehouses and coastal shipping. CVRD shares are traded on the São Paulo (Bovespa), New York (NYSE) and Madrid (Latibex) stock exchanges.

www.cvrd.com.br

Companhia
Vale do Rio Doce

THE ABCs OF ADRs

INVESTING IN FOREIGN STOCKS

U.S. investors. The first ADR was created in 1927 by JPMorgan as a vehicle for U.S. institutional investors to indirectly own shares of Selfridges, the British retail chain, despite U.K. restrictions prohibiting the actual securities from leaving the country.

Today, some 1,812 foreign companies from over 80 countries have depositary receipt programs – and there are currently 462 ADRs listed on national stock exchanges, mostly on the NYSE, which has 328 listed ADRs. Another 940 ADRs trade in the over-the-counter (OTC) market. Despite their foreign accent, many ADRs have long been household names familiar to U.S. investors, companies like Cadbury Schweppes, Honda, Sony, and Novartis.

ADRs certify that the underlying shares of a non-U.S. company have been deposited with the depositary's custodian in the company's home country. ADRs most often represent an equivalent number of shares – but occasionally the ratio of ADRs to underlying shares may differ. So, for example, one ADR might represent a fraction of the underlying share and another might represent 2 or 3 shares of the issuing company.

Although ADRs are, in fact, issued by a depositary institution, the foreign companies whose shares they represent and which, in most cases "sponsor" their issuance, are often referred to as the "issuers."

Importantly, ADRs are U.S. securities and, as such, they are

DESARROLLADORA HOMEX

Country: Mexico

Industry: Home Construction

Exchange: NYSE

Symbol: HXM

Market Cap: $1.837 billion

Recent Share Price: $36.77

52-week range: $26.74-39.26

Info: www.homex.com.mx

IR Contact:
Carlos Moctezuma
Investor.relations@homex.com.m
+52-667-758-5800

Key Facts: Homex is a verticall integrated home development company focusing on affordable entry-level and middle-income housing in Mexico. It is the largest builder of single-family homes in Mexico.

THE ABCs OF DEPOSITARY RECEIPTS

Not all depositary receipts are created equal. Here's a brief overview of DR terminology.

The majority of DRs are **"Sponsored"** – that is, they are issued by a depositary on behalf of a non-U.S. client corporation wishing to establish a presence in the United States, often to broaden its shareholder base, improve its share valuation, raise equity capital in this country, or achieve other strategic objectives.

Level 1 ADRs are the easiest, least costly way for non-U.S. companies to establish a presence in the U.S. They do not require full compliance with SEC reporting requirements and are exempt from Sarbanes-Oxley financial disclosure. However, these ADRs may not be listed on a national stock exchange or used for raising new equity capital. They can, however, trade in the U.S. over-the-counter market.

Level II ADRs must comply fully with SEC registration and reporting requirements as well as Sarbanes-Oxley's more stringent disclosure – and they may be listed on any of the three national stock exchanges. Issuers usually do not use a Level II ADR to raise capital.

Level III ADRs require still more stringent and costly financial disclosure. They are typically issued to raise new equity capital in the United States and may be exchange listed.

SEC Rule 144A ADRs are issued on behalf of non-U.S. companies wishing to raise equity capital in the United States through the private placement of depositary receipts with larg U.S. institutional investors. Rule 144 ADRs do not require registration with the Securities and Exchange Commission.

SEC Regulation S DRs – also known as **Global Depositar Receipts** or **GDRs** – are used to raise equity capital outside the United States. They do not require SEC registration and are not subject to U.S. regulatory supervision. However, U.S investors may not purchase Reg S DRs. **Global Depositary Receipts** are traded outside the United States, principally in London and Luxembourg, and are subject to the rules of the exchanges where they are listed or traded.

"Unsponsored" ADRs are sometimes issued by depositary institutions in response to U.S. investor demand for a foreign stock. These are issued without a formal agreement with the foreign company whose shares they represent – that is without their sponsorship.

The only **NYSE** listed **MEXICAN** homebuilder

ladora Homex, S.A. de C.V. is a vertically integrated home development y focused on affordable entry-level and middle-income housing in Mexico. ear ended December 31, 2005, Homex's revenues increased 55.4% to over million; EBITDA rose to US$187 million; and homes sales reached 31,594, a crease over 2004. Homex is the fastest growing of the major publicly listed velopers in Mexico based on the yearly increase in the number of homes sold, s and net income.

nas a scalable and standardized business platform that allows it to enter new rapidly and efficiently. With operations in 26 cities and 17 states, the y is one of the most geographically diversified homebuilders in Mexico. Since n June 2004 on the Mexican Bolsa and New York Stock Exchange, Homex has ed significant first of their kind transactions for the Mexican housing sector, g a large acquisition and the offering of Senior Guaranteed Notes. With its s-Oxley compliance program, NYSE listing and SEC filings, Homex maintains ional standards of accountability, transparency and corporate governance.

70%*

*ADR performance since IPO (June 28, 2004) to June 30, 2006.

HOMEX

Seguro vives aquí

HXM
LISTED
NYSE

For more information please log on to our website and check our 2005 Annual Report at:

http://hxm.client.shareholder.com/annuals.cfm

Investments

in biofuels, solar, wind, hydrogen, natural gas.

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It's a start.

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BP
A Very Americ Foreign Stock

Investing in foreign stocks? No discussion of international investin and portfolio diversification is com without consideration of BP. After all, it is the largest non-U.S. comp measured by market capitalization traded on the New York Stock Exchange. And, headquartered in London, it is the largest energy co based outside the United States.

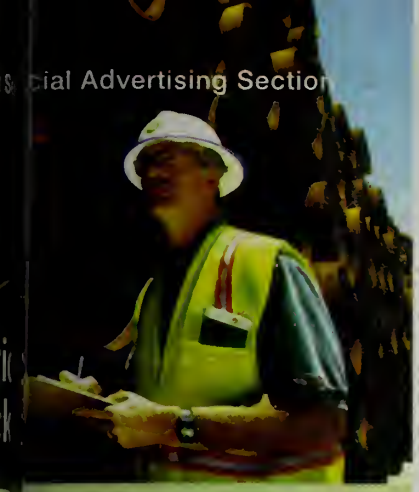
Talk about international, BP oper globally with business activities ir more than 100 countries. Import through its 50% ownership in the BP joint venture it is the largest f investor in Russia's energy secto

SMART INVESTING

To replace reserves and further di internationally, Rachael MacLean, Vice President, Investor Relations North America, says they're inves over $15 billion this year in capital projects around the world focusin five new profit centers – the Gulf c Mexico, Angola, Trinidad, Azerbaij and the Asia-Pacific Region.

BP's Russian investment was onc scorned by competitors as too ris Fadel Gheit, senior vice president energy analyst at Oppenheimer & investment advisors, says "the fa of the matter is that they made ar incredible investment. Russia is a cow for BP. They'll continue to cli coupons forever."

The company is well positioned to benefit from Russia's great pot says MacLean, adding "Russia is important on a global scale not o as an oil producer but because it the largest known accumulations natural gas in the world – and we a good track record of performan in that country."



OME IN THE STATES

foreign stock, BP is amazingly can: It is the largest producer and gas in the United States; nds – BP, Arco, Amoco, and l motor oil – are familiar across untry; and nearly 40% of its s are held by American investors.

very much like most other NYSE- companies because it is a U.S. -denominated company. BP ntants do their bookkeeping in s, most of its oil and gas products aded in dollars, its dividends to holders are declared in dollars, r American investors dividends aid in dollars. In addition, as ean points out, "since the ation of the U.S.-U.K. tax treaty ear, there are no withholding taxes laim from Britain's tax collector."

NCIAL STRENGTH

king of dividends, BP has a g financial track record paying nds in U.S. dollars every er for the last 14 years. Dividend ents have risen by 13% on ge over the last five years. And, rding to MacLean, its dividend of around 3.2% lately makes the attractive to retail investors and income portfolios.

g with their targets to reinvest rowth and to pay progressively r dividends, BP management is mitted to distributing 100% of free flow (after capital expenditures) vestors, primarily in the form vidends and share buybacks. rding to Oppenheimer analyst l Gheit, BP's dividend growth stock buyback program is a creative strategy" to create for shareholders and boost tock performance.

Because we think it's important to diversify, too.

Building a diverse portfolio is one way we're investing in the new energy future. Over the last 5 years, we've invested $30 billion in U.S. energy supplies, like cleaner burning natural gas.
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THE ABCs OF ADRs

INVESTING IN FOREIGN STOCKS

regulated by the Securities and Exchange Commission. They are denominated in U.S. dollars – and like other U.S. securities they trade in dollars. ADR owners also receive dividends in dollars and corporate communications are in English. ADRs are bought, sold, and clear just like any U.S. equity – and transactions costs are also similar. As U.S. securities, they can be held by U.S. institutional investors, such as pension plans, which otherwise may be prohibited by their own charters from owning non-U.S. securities.

Depositary institutions, like JPMorgan, provide a variety of services that are important not only to the foreign companies, on whose behalf they issue ADRs, but also to the retail and institutional investors who buy, hold, and sell ADRs. Importantly, it is their function to create and cancel ADRs on behalf of investors so that the supply and demand for ADRs in the U.S. market remains in equilibrium with the supply and demand for the underlying shares in the home market. This assures that prices in both markets are always comparable, allowing for transactions costs at the current exchange rate.

So, for example, if the price of an ADR on the New York Stock Exchange rises above the price of the underlying security in the home country market (at the current exchange rate and allowing for transactions cost) investors will likely buy shares locally, place the certificates with a custodial agent in the home country, and have the depositary bank issue new ADRs, increasing the supply available in the U.S. market.

JPMorgan's James Keane points out that an ADR is "a mechanism that needs to be executed – creating and cancelling ADRs to maintain price equilibrium between the U.S. and home market, handling corporate actions, managing shareholder accounts, transferring ADRs between buyers and sellers, communicating with shareholders, converting foreign currency dividends and paying U.S. shareholders." It is these "behind-the-scenes" activities that make U.S. investment in foreign equities through the mechanism of American Depositary Receipts virtually indistinguishable from investment in the shares of any American company.

BP

Country: United Kingdom

Industry: Energy

Exchange: NYSE

Symbol: BP

Market Cap: $237.56 billion

Recent Share Price: $71.74

52-week range: $63.26-76.85

Info: www.bp.com

IR Contact:
Mary Jane Klocke
ir@bp.com
212-421-5010

Key Facts: BP is the largest non-U.S. company listed on the New York Stock Exchange, the world's second biggest oil producer, and the biggest oil and natural gas producer in North America.

ADRs FOR THE RETAIL INVESTOR

Ease of Use – ADRs are quoted in U.S dollars, trade just like U.S. equities, and settle through a U.S. clearinghouse just a U.S. security.

No-Hassle Dividends – ADR investo receive their dividend checks prompt and in U.S dollars.

Access – ADRs offer U.S. investors e low-cost access to some of the world best equity investment opportunities.

Do-it-yourself International Diversification – Unlike mutual funds an ETFs, ADRs give U.S. investors wh want global diversification the opportunity to select exactly the foreig companies they like.

English Spoken Here – Corporate communications, including shareholde reports, financial statements, and cor rate actions are translated into Englis for ADR holders. Plus, current trading data is readily available.

Transparency – Issuers of exchange-traded ADRs are required to maintain the same financial reporting standard as U.S. companies with comparable exchange listings.

Lower transactions costs – Brokerage commissions on ADRs are similar to commissions on other U.S. equities. And international investing through ADRs avoids foreign brokerage and currency exchange commissions.

Lower custody fees – Foreign custo fees range from 10 basis points per year on the value of the investment in developed markets to more than 35 basis points per year in emerging markets. By contrast, custody fees o ADRs – as with U.S. equities – are oft no more than $35 and are not based the value of the securities.

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EUROPEAN LEADERSHIP FORUM 2006

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Performance and Innovation

22 November 2006, Claridges, London

While Europe looks set to enjoy a firm but moderate recovery of her economy, the most global European companies are producing stellar results, consistently outperforming the market and their respective economies. Identified by BusinessWeek as the 'European 50', the listing highlights an élite group of corporates who are helping Europe create a class of truly global champions.

BusinessWeek's annual European Leadership Forum will celebrate these high-performance businesses and their leaders by putting a spotlight on the companies who make up the 'BusinessWeek European 50'. This year's program will feature CEOs from Europe's top performers - sharing their learnings about what makes them top of class and tackling the issues of corporate strategy and performance. The forum will also feature panels focused on the increasingly important role innovation and design play in creating world-class companies.

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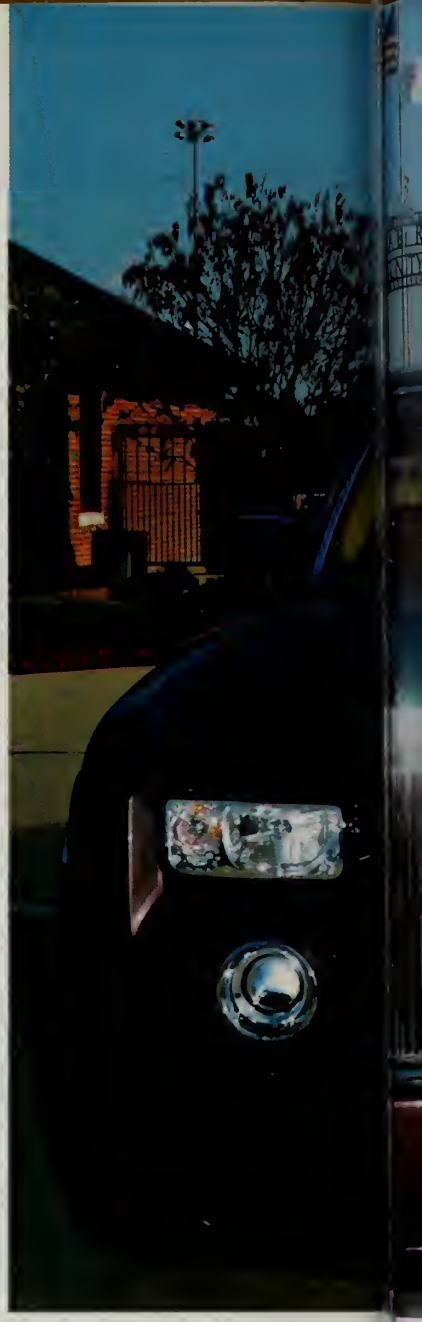
Phantom Respect

BMW's new Rolls-Royce Phantom drives like a dream, but does the brand still turn heads? BY DAVID WELCH



PHOTOGRAPHS BY DONNA TEREK; (LOGO) ROLLS-ROYCE MOTOR CARS/VIA BLOOMBERG NEWS

ROLLS-ROYCE: THE name reeks of wealth, luxury, and excess. For a kid like me growing up in rusted-out Syracuse, N.Y., it stood for something otherworldly and unattainable. It was enough, the vision of this powerful car with its endless front, to once make me pump $5 into a gumball machine trying to coax out a cheap plastic copy of Rolls's "Spirit of Ecstasy" hood ornament.

Even today, I love the idea of a Roller. So when the company offered me a new $330,000 Phantom to test drive for the weekend, I grabbed it. This is the first new Rolls since BMW took over the British carmaker in 2003, ending decades of sometimes poorly made yet magnificently appointed vehicles. I looked forward to driving this beauty proudly through my prosaic world. People would stop me to admire the car and pepper me with questions. What a kick.

Or not. On the first day, I pulled it into the grocery store lot and people stood there gawking. While I got the requisite thumbs up from some, no one stopped me to get the low-down on the car the way people did when I test drove the Lamborghini Murciélago or the Bentley Continental GT. (The sight of the Bentley prompted a fellow to follow me for two miles just to ask what I was driving.) These were more looks of disbelief that a guy wearing Chuck Taylors and long sideburns was behind the wheel of a such a car.

Later, at the public ball field where my baseball team had a game, I was unpack-

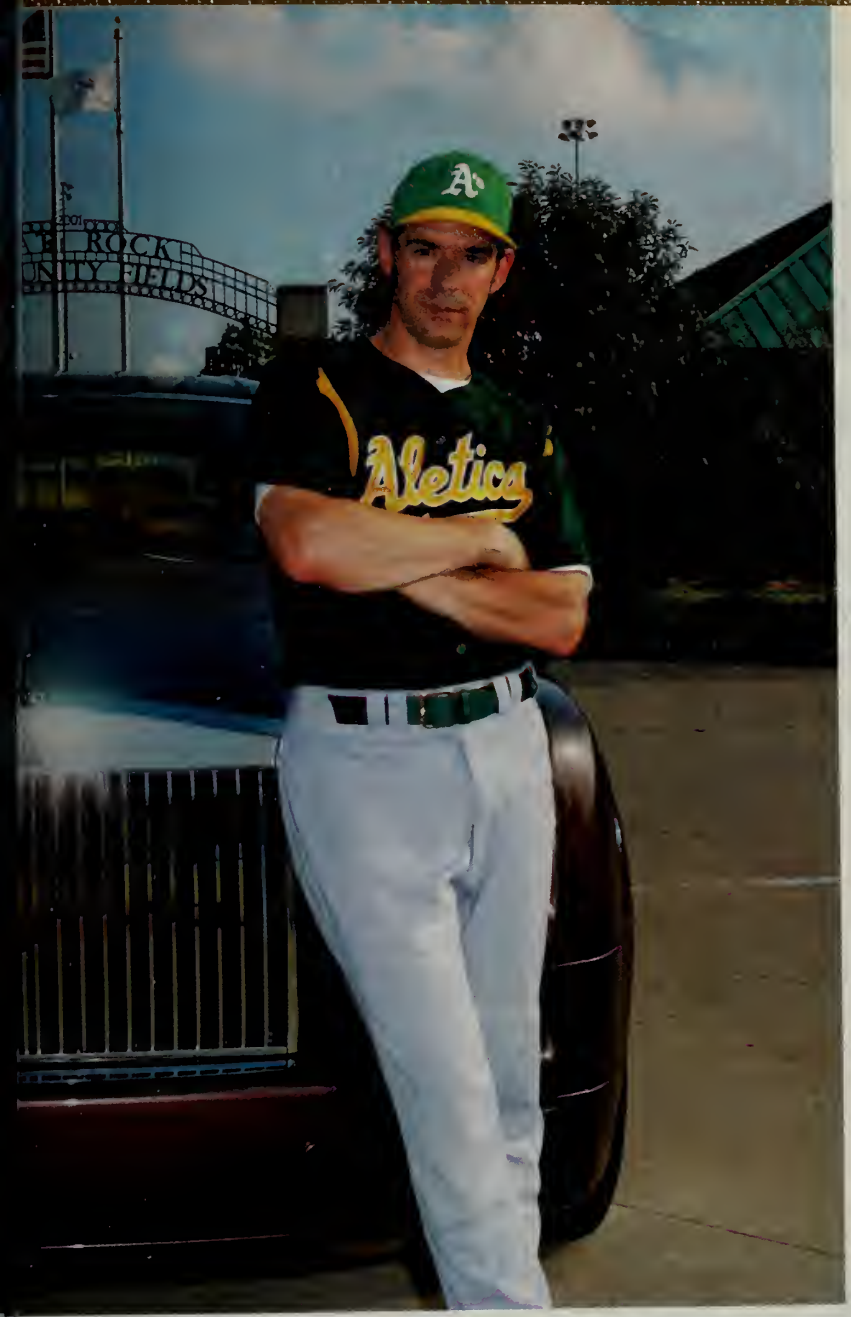
Check Out My Ride

OUT TO THE BALL GAME Writer Welch drives the Phantom to the ballpark—and takes a ribbing from teammates

EASY ACCESS Coach doors will swing shut at the press of a button

NOT FAST ENOUGH While this pick-up window photo was being snapped, other customers were more annoyed with the delay than impressed with the car

DIGNITY INTACT Bringing back that new-car shine



ing bats from the "boot" when my teammates started ribbing me. One quipped that the next time I get an opportunity to drive one of these cars might be if some millionaire hires me to take it to a car wash. By the way, I did take it to the car wash. My garage was too small for this 20-foot beast, and some local blue jays splattered up the hood while it was parked in the driveway.

Don't get me wrong. I thoroughly enjoyed driving this car. It floated over speed bumps as if they didn't exist, and despite its 6,600-pound bulk, the car handled like a Honda. Its V-12 engine can get from 0 to 60 mph in 5.7 seconds.

Still, people were not in awe of the car, as I expected. On Sunday, I figured holding up the line at a McDonald's drive-through while our photographer took pictures would be no problem. Who wouldn't wait a few more minutes to get a Big Mac when they could get a close-up look at the rear end of a new Rolls? Instead, the guy in the pickup behind me started blaring death metal and screamed for us to move.

Why didn't the Phantom, with its massive presence and majestic chrome grill, get the respect of other exclusive rides? My theory: The flowing sensuality that has been a hallmark of classic Rollses has been replaced by a squared-off, almost austere Teutonic design. It doesn't have the princely presence of the Rolls of old.

BMW did a masterful job of engineering this car, and the craftsmanship is Rolls-worthy. But it seems like an anachronism. While car buffs still revere the name, they'd rather drive the sporty new-age Bentleys and high-end Porsches. Can you imagine the Google guys tooling around in a Rolls?

BY ROBERT PARKER

Australian Shiraz: More Bang per Buck

IN FRANCE AND in California, they call it syrah. Down Under, the same grape and the wine made from it are known as shiraz, with the "a" pronounced as in "hat." (The second syllable is "ahs" in the U.S.) However you pronounce it, shiraz thrives under Australia's searing sun, where it is the most widely cultivated grape and produces its finest wine. As with most Aussie wines, you don't have to spend a lot to get a great pou

Woop Woop 2004 Shiraz

89 points. This 100% shiraz from South Australia sees some oak, a small amount of which is new wood. (New barrels impart more flavor than those that have been used before.) Notes of flowers, black currants, licorice, and road tar are discernible, but the emphasis is on oodles of up-front fruit, an opulent attack, sweet tannin, and a lush, heady mid-palate and finish. This is the type of everyday red that will be exceptionally popular. Enjoy it over the next two to three years. $11

Hill of Content 2003 Shiraz

89 points. It has smoke, licorice, blackberry as well as black currant characteristics, enticing texture, and an opulent, long, heady finish. Consume over the next three to four years. $14

Shoofly 2004 Shiraz

88 points. Shoofly's fruit-driven shiraz reveals a deep ruby/purple color, medium-to-full body, abundant amounts of blackberry and cassis fruit, and hints of licorice, spice, and earth. Enjoy this attractive red over the next few years. $14

Marquis Philips 2004 Shiraz

90 points. Displaying blackberry, tar, pepper, and toasty oak characteristics in its spicy, rich, deep, voluptuous personality, this wine will drink well for one to three years. $15

Rolf Binder Wines 2003 Shiraz Hales

89 points. With 5% cabernet sauvignon blended in, this unfiltered cuvée offers a dense ruby/purple color along with a big, sweet nose of creamy vanillin, blackberries, coconut, and pepper. Consume this chewy, fleshy, up-front shiraz over the next two to three years. $15

Winner's Tank 2004 Shiraz

91 points. This shiraz is a new venture between Kaesler Vineyard's winemaker, Reid Bosward, and the owners of Winner's Tank, David and Kathy Knight. Given minimal aging in French oak, it offers an opaque purple color as well as exuberant, concentrated blackberry and cassis aromas revealing a touch of acacia flowers. It's full-bodied, opulently textured, and loaded. I served this cuvée bl guests who were convinced it was a $50 bo of wine. Drink this big, black, shiraz baby ov the next two to three years to take advanta its exuberant fruit. $15

Charles Cimicky 2004 Shiraz Tru

90 points. This outstanding 100% shiraz in old wood exhibits a dark ruby/purple hu along with a forceful, flamboyant nose of t tar, blackberry and cassis fruit, licorice, an pepper. Opulent, savory, and expansive, it provide thrilling drinking over the next two three years. $18

Torbreck 2004 Woodcutters Shir

91 points. Aged completely in old wood, i offers pure blackberry liqueur notes intermixed with hints of charcoal, tar, and pepper. This soft, velvety textured, opulen fruit-filled shiraz is amazingly complex fo its price. It is a lusty, appealing, hedonist' dream to consume over the next four to fi years. $20

Visit **www.eRobertParker.com** for the Internet's most active wine bulletin boa tens of thousands of tasting notes, or to order his recent book, *The World's Greatest Wine Estates: A Modern Perspective*. You can also subscribe to Parker's newsletter, *The Wine Advocate*. Request a sample copy at: *The Wine Advocate*, P.O. Box 311, Monkton, MD 21

Wines rated from 96-100 are extraordinary; 90-95, excellent; 80-89, above average to very good. For more Parker picks, go to businessweek.com/ex

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CKS

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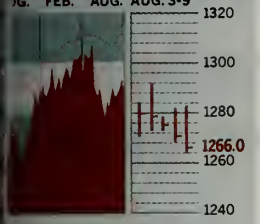

MENTARY

ock market struggled to
divergent messages this
The Fed opted not to hike
st rates for the 18th time in
but investors found little to
rate in the face of a slowing
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s. Oil prices continued to
ind with the Fed vowing
nce on inflation, the
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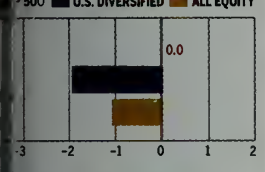
oomberg Financial Markets, Reuters

TUAL FUNDS

EEK TOTAL RETURN
ENDED AUG. 8
P 500 U.S. DIVERSIFIED ALL EQUITY



VEEK TOTAL RETURN
ENDED AUG. 8
P 500 U.S. DIVERSIFIED ALL EQUITY

Standard & Poor's

U.S. MARKETS	AUG. 9	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P 500	1266.0	-1.0	1.4	2.8
Dow Jones Industrials	11,076.2	-1.1	3.3	4.3
NASDAQ Composite	2060.3	-0.9	-6.6	-5.2
S&P MidCap 400	726.8	-1.9	-1.5	2.8
S&P SmallCap 600	354.5	-1.8	1.1	2.7
DJ Wilshire 5000	12,638.7	-1.2	1.1	3.1
SECTORS				
BusinessWeek 50*	714.4	-0.5	-3.7	-3.4
BW Info Tech 100**	370.7	0.1	-2.6	-0.4
S&P/Citigroup Growth	584.8	-0.6	-2.0	-1.1
S&P/Citigroup Value	679.6	-1.4	4.9	6.9
S&P Energy	443.2	-0.2	18.9	19.2
S&P Financials	436.6	-1.6	2.4	9.7
S&P REIT	173.1	-0.5	13.1	17.2
S&P Transportation	233.9	-4.1	-6.4	5.3
S&P Utilities	171.9	-0.9	7.6	7.6
GSTI Internet	158.6	1.5	-22.7	-10.6
PSE Technology	756.3	-1.8	-9.6	-5.3

*Mar. 19, 1999=1000 **Feb. 7, 2000=1000

GLOBAL MARKETS	AUG. 9	WEEK	% CHANGE YEAR TO DATE	% CHANGE LAST 12 MONTHS
S&P Euro Plus (U.S. Dollar)	1719.3	0.7	13.7	19.1
London (FT-SE 100)	5860.5	-1.2	4.3	9.3
Paris (CAC 40)	5025.2	0.0	6.6	11.9
Frankfurt (DAX)	5702.8	0.4	5.4	16.2
Tokyo (NIKKEI 225)	15,656.6	1.2	-2.8	31.6
Hong Kong (Hang Seng)	17,346.6	1.8	16.6	15.3
Toronto (S&P/TSX Composite)	12,008.2	0.3	6.5	13.4
Mexico City (IPC)	20,062.4	-0.4	12.7	36.7

FUNDAMENTALS	AUG. 8	WEEK AGO	YEAR AGO
S&P 500 Dividend Yield	1.88%	1.85%	2.00%
S&P 500 P/E Ratio (Trailing 12 mos.)	16.8	16.8	19.4
S&P 500 P/E Ratio (Next 12 mos.)*	13.9	13.9	15.5
First Call Earnings Surprise*	-0.36%	-0.41%	0.22%

*First Call Corp.

TECHNICAL INDICATORS	AUG. 8	WEEK AGO	READING
S&P 500 200-day average	1269.9	1267.6	Negative
Stocks above 200-day average	51.0%	50.0%	Neutral
Options: Put/call ratio	0.82	0.90	Positive
Insiders: Vickers NYSE Sell/buy ratio	2.45	2.52	Neutral

BEST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Home Entrtnmt. Sftwre.	15.4	Agricultural Products	103.4
Tires & Rubber	8.8	Steel	72.0
Health-Care Services	8.4	Divsfd. Metals & Mining	57.5
Power & Energy Traders	7.9	Oil & Gas Refining	43.9
Health-Care Facilities	7.8	Constr. & Engineering	42.1

WORST-PERFORMING GROUPS	LAST MONTH %		LAST 12 MONTHS %
Internet Retailers	-27.4	Internet Retailers	-41.5
IT Consulting	-21.0	Educational Services	-40.6
Trading Cos. & Distribs.	-17.9	Homebuilding	-36.0
Air Freight	-17.4	Tires & Rubber	-34.4
Photographic Products	-16.2	Photographic Products	-25.4

EQUITY FUND CATEGORIES 4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEAGERS		LEAGERS	
Utilities	3.1	Precious Metals	68.2
Latin America	2.8	Latin America	42.7
Diversified Emrg. Mkts.	1.5	Diversified Emrg. Mkts.	27.3
Europe	1.2	Japan	26.4
LAGGAROS		LAGGAROS	
Small-cap Growth	-4.8	Technology	-4.2
Mid-cap Growth	-3.8	Large-cap Growth	-0.3
Technology	-3.7	Health	0.7
Small-cap Blend	-3.3	Small-cap Growth	1.1

EQUITY FUNDS 4-WEEK TOTAL RETURN	%	52-WEEK TOTAL RETURN	%
LEAGERS		LEAGERS	
DireXn. Sm. Cap Br. 2.5X Inv.	8.6	U.S. Global Invrs. Gold	105.8
DireXn. NASDAQ 100 Br. 2.5X Inv.	8.4	Midas	101.5
ProFunds Pharmctcls. Inv.	7.8	U.S. Glbl. Invs. Prc. Mnls.	98.1
iShares Silver Trust	7.4	Van Eck Invrs. Gold A.	86.0
LAGGAROS		LAGGAROS	
Ameritor Investment	-33.3	Ameritor Investment	-81.8
American Heritage Grth.	-25.0	American Heritage Grth.	-50.0
ProFds. Mble. Tlcmms. Inv.	-15.0	ProFunds. Semicdr. Inv.	-28.6
Rydex Transportation Inv.	-13.9	ProFds. Mble. Tlcmms. Inv.	-26.9

INTEREST RATES

KEY RATES	AUG. 9	WEEK AGO	YEAR AGO
Money Market Funds	4.82%	4.80%	2.91%
90-Day Treasury Bills	5.07	5.11	3.51
2-Year Treasury Notes	4.91	4.95	4.11
10-Year Treasury Notes	4.94	4.97	4.39
30-Year Treasury Bonds	5.05	5.05	4.57
30-Year Fixed Mortgage †	6.37	6.46	5.83

†BanxQuote, Inc.

BLOOMBERG MUNI YIELD EQUIVALENTS

Taxable equivalent yields on AAA-rated, tax-exempt municipal bonds, assuming a 30% federal tax rate.

	10-YR. BOND	30-YR. BOND
General Obligations	3.99%	4.40%
Taxable Equivalent	5.70	6.29
Insured Revenue Bonds	4.07	4.55
Taxable Equivalent	5.81	6.50

THE WEEK AHEAD

UCER PRICE INDEX
day, Aug. 15, 8:30 a.m. » Producer prices most rose by 0.4% in July after a jump in June. That's the an forecast of economists yed by Action Economics. s food and energy, wholesale s probably grew 0.2% for a nd straight month.

SUMER PRICE INDEX
Inesday, Aug. 16, 8:30 . EDT » Consumer prices for goods and services probably increased 0.4% in July, after a 0.2% gain in June. Minus food and energy, the index is expected to have climbed 0.3% for the fifth straight month. A comparable streak last occurred in early 1993.

RESIDENTIAL CONSTRUCTION
Wednesday, Aug. 16, 8:30 a.m. EDT » Housing starts in July most likely slowed to an annual pace of 1.83 million, from a pace of 1.85 million in June.

INDUSTRIAL PRODUCTION
Wednesday, Aug. 16, 9:15 a.m. EDT » Factory production probably expanded by 0.5%, after a 0.8% jump in June. The factory utilization most likely climbed to 82.7%, from 82.4%.

LEADING INDICATORS *Thursday, Aug. 17, 10 a.m. EDT* » The Conference Board's index of leading economic indicators is forecast to have edged up by 0.1% for a second straight month.

The *BusinessWeek* production index held pretty steady at 285.2 for the week ended July 29, a 13.2% rise from a year ago. Before calculation of the four-week moving average, the index eased back to 282.8.

BusinessWeek online

For the BW50, more investment data, and the components of the production index visit www.businessweek.com/extras

BY GENE G. MARCIAL

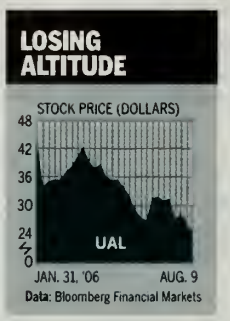
FLYING UNITED: THE BUZZ SAYS UAL MAY BE RIPE FOR A MERGI

WHY A BIG STEELMAKER COULD SNAP UP COMMERCIAL METAI

REPLIGEN'S PROSPECTS ARE BRIGHT, FOR OLD AND NEW DRUG

United and Continental?

AFTER COMING OUT OF BANKRUPTCY on Feb. 1 much leaner, United Airlines' parent, UAL (UAUA), is drawing fresh attention for its turnaround efforts. There's also buzz of a merger with Continental Airlines. The two have talked in the past, and some pros think the effort will be rekindled. One money manager who owns UAL shares, has close ties with executives, and asked not to be named, says Continental has not given up. "The strategic fit [would] be great," he argues. A merger would make UAL-Continental tops in the U.S. In passenger revenues, UAL is second only to AMR, parent of American Airlines. Combined, UAL and Continental, now No. 5, would have sales of $30 billion, vs. AMR's $20.7 billion.



Since March, UAL stock has fallen from 43 to 23.83. Helane Becker of investment firm Benchmark, who rates UAL a "buy," says the rumored merger is "entirely possible." Apart from the fit, she says, a merger would remove "overlapping capacity" from the system. Since Chapter 11, UAL's labor costs are competitive with those of low-cost airlines, notes Becker. She has a 12-month price target of 43, based on eight times her estimated 2007 profit estimate of $5.32 a share. For 2006, she expects a loss of 25¢. Roger King of CreditSights.com notes in a report that UAL is strong in Asia, while Continental is strong in the Atlantic. That suggests that a merger would strategically benefit both. UAL and Continental both declined comment on merger rumors.

Commercial Metals Could Get Welded

FURTHER CONSOLIDATION in the global steel industry is in the cards, argues Standard & Poor's analyst Leo Larkin. "Sharply rising costs for raw materials, such as iron ore and ferrous scrap, are exerting pressure to merge," he says. Steel producers need to expand, he notes, to obtain more favorable contracts from ore miners. One potential target, according to Larkin, is Commercial Metals (CMC), which makes and recycles steel and other metals. It has attractive assets in steel production, fabrication, and scrap recycling. In the U.S., Nucor and U.S. Steel are likely purchasers, he says. Larkin rates CMC a "buy" and sees it earning $2.54 a share in 2006 and $2.80 in 2007, vs. $2.31 in 2005. Andrew Schmeidler of investment outfit AR Schmeidler, which owns shares, says CMC stands out because it's undervalued, based on assets. The stock hit 31 in May but has slid to 22.89. It could rise to 35 in 18 months, Schmeidler says. A CMC spokeswoman said executives could not be reached for comment.

Repligen May Hit 'A Home Run'

SHARES OF BIOTECH REPLIGEN (RGEN) popped 2 to 3, on July 31 when a federal judge ruled that its lawsuit seeking royalties from ImClone Systems co proceed. The suit claims that ImClone is using Repligen' patented technology (licensed from Massachusetts Instit of Technology) to enhance production of ImClone's colo cancer drug Erbitux. Eric Ende of Merrill Lynch in a rep says ImClone could end up paying 1% to 2% of Erbitux s which Repligen estimates at $1 billion. But for Elemer P of Rodman & Renshaw, Repligen's allure is in its produc already on the market, plus others in clinical trials, such as secretin for schizophrenia, and uridine, in Phase 2 trials, for bipolar depression. Repligen's Protein A, to boost antibodies, and SecreFlo, to diagnose pancreatitis and gastrinoma, a rare cancer, had sales of $12.5 million in the year ended Mar. 31, 2006. Stanley Medical Research, which funds work on schizophrenia and bipolar disorder, is conducting the studies. Pros rates the stock, now at 2.62, "outperform/ speculative," with a 12-month target of 5. He sees 2007 s of $14 million. Soros Fund Management and Vanguard Group are among the big investors. Private investor Ron Chez of Ronald L. Chez Inc. which owns shares, predicts Repligen "will hit a home run" with its new products.

BusinessWeek online Gene Marcial's Inside Wall Street is poste businessweek.com/investor at 5 p.m. EST on the magazine's publication day, usually Thursdays.

Note: Unless otherwise noted, neither the sources cited in Inside Wall Street nor t firms hold positions in the stocks under discussion. Similarly, they have no invest banking or other financial relationships with them.

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Total returns are calculated quarterly using the daily 4:00 p.m. net asset value (NAV). Distributions, if any, are assumed to be reinvested back into the fund on the pay date at the NAV on that date. Performance data quoted represents past performance and is no guarantee of future results. Current performance may be lower or higher than quoted. The investment return and principal value of an investment will fluctuate so that an investor's shares, when sold or redeemed, are subject to market volatility. They may be worth more or less than their original cost. MDY shares are bought and sold at market price (not NAV) and are not individually redeemed from the fund. Brokerage commissions will reduce returns. To obtain most recent month-end performance, please call 1-800-843-2639 or visit www.MidCapSPDR.com.

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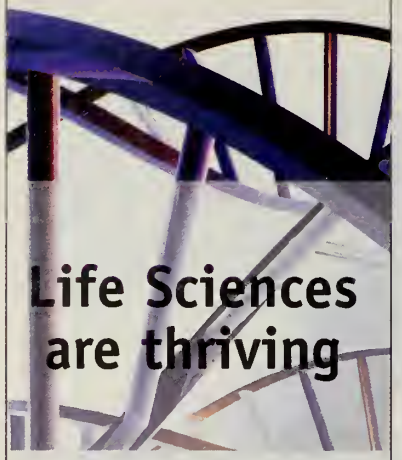

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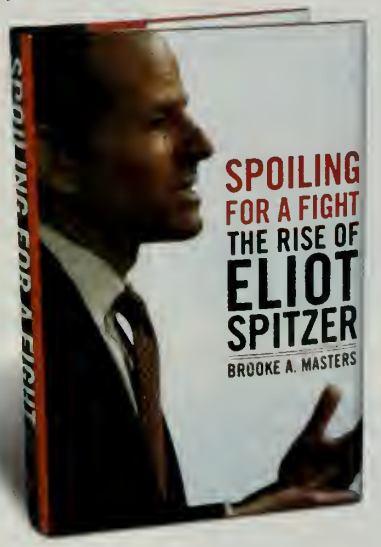
Lots of Evidence, No Verdict

SPOILING FOR A FIGHT The Rise of Eliot Spitzer
By Brooke A. Masters; Times Books; 353pp; $26

In 2003, Stephen M. Cutler, then head of the U.S. Securities & Exchange Commission's Enforcement Div., offered an impromptu roast of New York Attorney General Eliot Spitzer at a function they both attended. Cutler quoted from an e-mail purportedly sent by Spitzer to heaven. "Dear God," it began, "It's my understanding that you are everywhere, including, apparently, the State of New York. As I read the Stamp Act of 1785, you are subject to regulation and taxation by the state of New York."



The quip, recounted in *Spoiling for a Fight: The Rise of Eliot Spitzer* by *The Washington Post* financial-markets reporter Brooke A. Masters, pokes fun at Spitzer's extraordinarily broad sense of his power as well as the sometimes obscure foundations on which he bases it.

There are many, including the targets of Spitzer prosecutions as well as fellow law enforcers, who have not been amused by the scope or style of his actions. While admirers consider him a populist crusader who stepped into a regulatory vacuum to uphold the rights of consumers and investors, critics cast him as an overzealous and self-aggrandizing bully who has usurped federal authority, trampled the rights of defendants, and pursued a personal agenda that is at odds with sound public policy.

Which view is more accurate? The question has gained urgency as Spitzer pursues the governorship of New York and may even harbor ambitions to higher office. Masters' book is a well-reported compendium of the high-profile probes that catapulted Spitzer onto the national stage, and it contains substantial input from allies and adversaries alike. Anyone seeking a balanced and full account of his tenure as AG will find it a worthwhile read. But those wanting help in forming an opinion of Spitzer will come away disappointed. The book's very evenhandedness is a problem because it allows readers of varying predilections to find support for their views. Masters also fails to draw her own conclusions about her subject, an unfortunate abdication of authorial prerogative.

Conservatives may be horrified to learn that Spitzerism is built in part on one of the cornerstones of their political philosophy: states' rights. "There has been this tremendous redistribution of legal power away from Washington... back to the states," Masters quotes Spitzer as telling a national meeting of the Federalist Society in 1999. "Attorneys general across the country can—not only can, but must—step fo into a void to ensure that the rule of law is enforced."

Spitzer eagerly charged into that void, filing cases anc forging settlements in matters involving pollution by Mi utilities, tainted research by Wall Street analysts, impro mutual fund trading, and rigged bidding in insurance. H targets have included Merrill Lynch, Citigroup, and Ame International Group, and he has tangled with the likes o former AIG Chairman Maurice R. "Hank" Greenberg an former New York Stock Exchange head Richard A. Gras For sweeping probes of the financial-services sector, the made aggressive use of New York's lit known 1921 Martin Act, which provic broad power to investigate and penal financial fraud.

To his fans, Spitzer reformed corru institutions and industries that were neglected by other regulators. Yet his frequent use of the media and such h pressure tactics as threatening a comp with criminal charges and forcing ou executives have led Spitzer's foes to ta him as a prosecutor run amok. Even a have often found his manner needless fractious and acerbic. At one point, Sp said the SEC was so ineffective that he "wouldn't let them handle a house closing." Later he told Masters that "j probably not the smartest thing to say But, he added, revealingly, "it was fur

His aggressive initiatives led to a ri chorus of criticism from business and the defense "In the years right after t collapse of the 1990s technology bubble and th implosion of Enron and WorldCom," Masters wr "Spitzer's penchant for revealing bad behavior a then demanding industr wide change had won all universal applause." But continues, "as the stock market began to recover Spitzer's probes hit a wider range of targets, concern was growing" about his methods and his objectives.

Invaluable reformer or prosecutor run amok? The author lets the reader decide

Masters is largely content to leave it at that, serving up criticism made by others, along with rebuttals offered by Spitzer or his defenders, rather than offering her own critique. The result is a book that is highly informative bu unlikely to change many minds. ■

–By Michael

IdeasFaceTime
WITH **MARIA BARTIROMO**

)n the Ground in China

ANG XIN is emblematic of the New China. pulled herself up from a life of poverty in ng Kong, studied economics at Cambridge versity, and worked in New York as an an- t for ING Barings and Goldman Sachs. v, Zhang, 41, and her husband, Pan Shiyi, Beijing-based SOHO China, a commercial residential real estate company that ds offices, malls, and hotels as well as sing. Recently, I talked with Zhang, whom ent time with last winter at os, about the feverish wth in China.

would you characterize the onment for business?

r year the economy is growing so lily and strongly, it looks like 10% . Growth in general is tremendous ite people saying it will slow down. If go around China, you will be zed...there is a real estate boom ywhere. The minute you step out of irport, you see billboards everywhere ng about real estate. That has the rnment worried about bubbles and le's ability to buy homes and ther that will affect social stability. That is why the govern- t is trying to control the prices of houses.

t exactly has the government done?

t, it raised the mortgage down payment. Before, the down nent would be 20%, and you would borrow 80% from the ks. Now the threshold has been raised from 20% to 30%, ne cost for individuals to buy a home is higher, and there has been a slight adjustment upward in interest rates. But government] didn't think that was enough, so it came up the idea that if a developer builds 100 apartments, only can be more than 90 square meters, which is considered -end. You hear about interest rate rises or about raising down payment, but you won't hear the stories of the 90 are meters.

ou think this scares business away—that you never know t the government will do next?

I think any policy has the ability to scare foreigners. That is why the funds have been very cautious coming to China. At the moment, though, [caution] is probably not a bad idea from a market perspective. Memories are still fresh from 1997, when the Asian financial crisis started after the real estate meltdown. A lot of money had come in from capital markets, and there were tons of empty buildings. The way China is growing now, everything needs to be presold in order to be built.

I am hearing that more and more Wall Street money is planning to come into China real estate. But so far it's more talk than action.

I believe the market has only one way to go, and that is to be more integrated and open. So it's only a matter of time before Wall Street money comes in. But the later the better for China, because the money coming in can be very irrational. What China is doing today is preventing a huge misjudgment of the market.

Are consumers spending a lot of money? Do people have money to buy?

Sure. If you have a factory in coastal China producing, say, shoes for Nike or shirts for Ralph Lauren, these are the people buying homes. Of course, there are people at all different levels of management at those factories who can afford to buy homes as well. In Beijing, 70% of the homes are privately owned already. So while it's true that if you look at the factory workers, they may not have enough means to buy a home, but go slightly higher on the income level, and they will. In our company in Beijing, we have 600 people, and I think more than half of them bought homes. They are ordinary office workers.

How has life in China changed?

When I grew up, we had nothing. Everyone used to make their own furniture. You would make your own chairs, table. Going from that to now shopping at IKEA...it's amazing what has happened in the past 25 years. We used to buy so many things for buildings that were imported...windows, toilets, air conditioners, flooring. Today less than 5% of our materials are imported. All of these factories that used to be in Germany and in America are today in China. China is the factory of the world.

Maria Bartiromo is the host of CNBC's Closing Bell.

Ideas The Welch Way

BY JACK AND SUZY WELCH

The Nitty-Gritty on Nepotism

I was recently hired as a manager at a family-owned company. My boss, the v.p. of marketing, is the CEO's wife. She never went to college, has no experience in marketing, yet micromanages everyone, including those of us with MBAs. I've just learned that several talented people have quit because of her, and that she fires anyone who disagrees with her, with her husband's full support. Short of quitting, how do I handle nepotism gone awry?

–Anonymous, Austin, Tex.

Not to be difficult here, but where the heck were you during the hiring process for this job?

We ask because it seems a little late for you to be discovering the kind of information that should be part of everyone's due diligence when considering employment at a family-owned company. Information like: how many cousins want your next promotion and whether it is fatal—or merely dangerous—to disagree with the CEO's next-of-kin.

Now, we're not implying that people should avoid working in family-owned companies, which offer some of the best jobs in business. But when you decide to work at a family operation, realize you are accepting a special deal. And every deal has trade-offs.

Working for a family-owned company can have benefits, but don't sign on till you do your research

With this one, the upside is real. Family-owned companies give you a level of collegiality and informality rarely found in corporate environments, with cultures that are, at their best, personal and warm. Employees can come to feel like family members, not numbers, and managers often have direct access to the stakeholders and decision-makers. You can really feel like you're in the game.

The downside is real too, as you are discovering. When you join a family-owned business, especially a small or medium-size one, you very often give up the adjudication process, for lack of a better term, that "enforces" fairness at professionally run organizations. That's not saying that public companies don't have their share of arbitrary bosses or favoritism. But the checks-and-balances at most public companies, such as employee satisfaction surveys and the "higher authority" of HR, do go a long way in giving employees a sense that there is a way for them to be heard during conflicts.

The only way to handle the absence of adjudication at family companies is to be prepared. Even if things are going well, employees should always have an exit strategy. And if you are considering joining a family company as a CEO, even a high-level manager, don't make a move unless you negotiate a severance package up front.

But what about your case? You don't seem to have a contract, and you say you don't want to quit. That means only choice is, well, to adjust. You have to figure out the b way to work with the CEO's wife. Forget her educational credentials, or lack thereof; she's still your boss. So slow your desire to make changes or speak out, and give her a chance to get to know—and trust—you.

Yes, proper due diligence during the hiring process mi have raised red flags, and perhaps you could have avoide mess you're in. But it's too late for that now. The nepotism you're encountering is part of the family-owned deal.

All this talk about winning makes me wonder, is there any p for losers in this world? Only a small percentage of people succeed; should all the non-winners just kill themselves?

–S. Gopal, Bang

What a question—it has to mean you see winning in pure economic terms. That's just not how it has to be.

We think about winning another way: as setting perso goals and achieving them, and (as importantly) enjoying experience on the way. Winning has nothing, or everythi to do with your job. Yes, you can win as a corporate execu but you can win just as meaningfully as a carpenter, math teacher, or singer in a wedding band. You can win raising family, caring for your parents, or being a good friend—as long as those are the dreams you picked for yourself. Inde the biggest winners in the world are those who answer ye the question, "Am I living the life I choose?"

One of the biggest winners we know is a person who b your economic definition would probably not qualify at al Jim O'Connell graduated from Harvard Medical School. B instead of pursuing a lucrative career, he has spent the pa years driving a van around Boston practically every night, delivering medical care to the homeless. He lives simply; Jim's life is full of joy, and he is beloved by everyone lucky enough to know him, from street people to senators.

Look, winning and losing can't be quantified. They are states of mind, and losing only happens when you give up Seen that way, then, the world can be filled with winners, there is room for them all.

Jack and Suzy Welch look forward to answering your questions about business, company, or career challenges. Please e-mail them at **thewelchway@businessweek.com.** *For their weekly podcast, go to www.businessweek.com/search/podcasting.htm*

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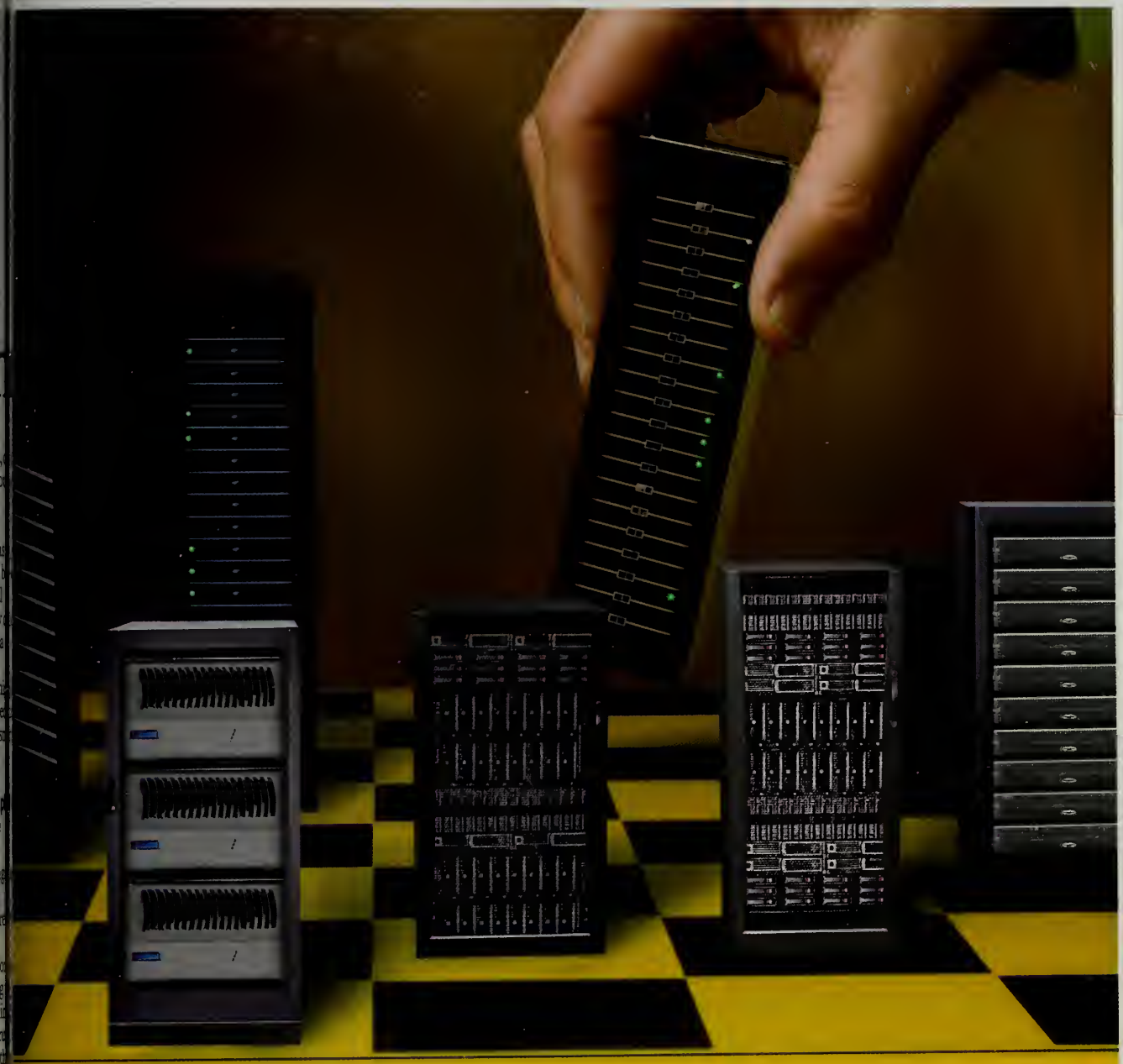

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